

CONSOLIDATED FINANCIAL STATEMENTS AND
REPORTS ON FEDERAL AWARD PROGRAMS

Ochsner Clinic Foundation and Subsidiaries
Year Ended December 31, 2017
With Reports of Independent Auditors

Ernst & Young LLP



Ochsner Clinic Foundation and Subsidiaries

Consolidated Financial Statements and Reports on Federal Award Programs

Year Ended December 31, 2017

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Ernst & Young LLP
3900 One Shell Square
701 Poydras Street
New Orleans, LA 70139

Tel: +1 504 581 4200
Fax: +1 504 596 4233
ey.com

Report of Independent Auditors

The Board of Directors and Management
Ochsner Clinic Foundation and Subsidiaries

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Ochsner Clinic Foundation and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

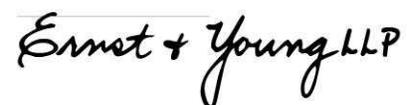
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Ochsner Clinic Foundation and its subsidiaries at December 31, 2017 and 2016, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information – Schedule of Compensation Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The Schedule of Compensation Information as required under Louisiana Revised Statute 24:513A(1)(a)(3) is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we also have issued our report dated April 23, 2018 on our consideration of Ochsner Clinic Foundation and its subsidiaries' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Ochsner Clinic Foundation and its subsidiaries' internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Ochsner Clinic Foundation and its subsidiaries' internal control over financial reporting and compliance.



April 23, 2018,
Except for the Schedule of Compensation Information
for which the date is June 28, 2018

Ochsner Clinic Foundation and Subsidiaries

Consolidated Balance Sheets
(In Thousands)

	December 31,	
	2017	2016
	<i>(As Adjusted)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 186,401	\$ 121,569
Assets limited as to use required for current liabilities	7,370	5,600
Patient accounts receivable – net	249,299	252,598
Accounts receivable other	104,827	99,516
Inventories	68,608	56,022
Prepaid expenses and other current assets	34,395	32,972
Estimated third-party payor settlements	22,224	19,626
Total current assets	<u>673,124</u>	<u>587,903</u>
Assets limited as to use:		
By Board for capital improvements, charity, research, and other	769,717	729,436
Under bond indenture agreements	95,106	21,477
Under self-insurance trust fund	9,301	9,135
Donor-restricted long-term investments	97,425	78,433
Total assets limited as to use	<u>971,549</u>	<u>838,481</u>
Less assets limited as to use required for current liabilities	<u>(7,370)</u>	<u>(5,600)</u>
Non-current assets limited as to use	964,179	832,881
Investments in unconsolidated affiliates, real estate, and other	19,644	14,045
Property – net	927,979	821,692
Goodwill	71,195	43,558
Intangible assets	12,354	11,467
Other assets	47,332	39,293
Total assets	<u><u>\$ 2,715,807</u></u>	<u><u>\$ 2,350,839</u></u>

	December 31,	
	2017	2016
	<i>(As Adjusted)</i>	
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 190,683	\$ 150,332
Accrued salaries, wages, and benefits	163,218	149,483
Deferred revenue	35,552	9,669
Estimated third-party payor settlements	4,275	3,769
Bonds payable – current portion	2,095	7,030
Notes payable – current	52,430	52,430
Long-term debt – current portion	13,299	15,566
Other current liabilities	33,266	30,927
Total current liabilities	494,818	419,206
Pension and postretirement obligations	147,596	166,532
Bonds payable	986,730	828,408
Long-term debt	175,722	188,693
Other long-term liabilities	38,770	36,982
Total liabilities	1,843,636	1,639,821
Commitments and contingencies <i>(Notes 5 and 17)</i>		
Net assets:		
Unrestricted	745,282	596,966
Temporarily restricted	100,206	88,219
Permanently restricted	26,683	25,833
Total net assets	872,171	711,018
Total liabilities and net assets	<u>\$ 2,715,807</u>	<u>\$ 2,350,839</u>

See notes to financial statements.

Ochsner Clinic Foundation and Subsidiaries

Consolidated Statements of Operations

(In Thousands)

	Year Ended December 31,	
	2017	2016
	<i>(As Adjusted)</i>	
Unrestricted revenues:		
Patient service revenue – net of contractual allowances and discounts	\$ 2,381,355	\$ 2,241,043
Provision for bad debts	(87,789)	(88,454)
Net patient service revenue, less provision for bad debts	2,293,566	2,152,589
Premium revenue	298,824	286,186
Other operating revenue	403,463	322,978
Net assets released from restrictions used for operations	6,319	6,040
Total unrestricted revenues	3,002,172	2,767,793
Expenses:		
Salaries and wages	1,359,294	1,258,517
Benefits	138,008	134,859
Medical services to outside providers	133,952	132,534
Medical supplies and services	570,155	500,792
Other operating expenses	552,756	522,155
Depreciation and amortization	128,098	115,832
Interest	49,762	52,718
Total expenses	2,932,025	2,717,407
Operating income	70,147	50,386
Non-operating gains (losses):		
Investment and other realized gains – net	47,147	7,613
Loss on early extinguishment of debt	(9,256)	(39,110)
Unrealized gains on alternative investments	32,290	10,241
Total non-operating gains (losses)	70,181	(21,256)
Excess of revenues over expenses	\$ 140,328	\$ 29,130

See notes to financial statements.

Ochsner Clinic Foundation and Subsidiaries

Consolidated Statements of Changes in Net Assets
(In Thousands)

	Year Ended December 31,	
	2017	2016
	<i>(As Adjusted)</i>	
Unrestricted net assets		
Excess of revenues over expenses	\$ 140,328	\$ 29,130
Net unrealized gains on investments excluding alternative investments	4,678	28,251
Net assets released from restrictions used for capital acquisitions	636	918
Pension-related changes other than net periodic pension costs	2,674	(26,449)
Increase in unrestricted net assets	<u>148,316</u>	<u>31,850</u>
Temporarily restricted net assets		
Contributions	13,002	25,892
Investment income	5,940	2,601
Net assets released from restrictions used for:		
Operations	(6,319)	(6,041)
Capital acquisitions	(636)	(918)
Increase in temporarily restricted net assets	<u>11,987</u>	<u>21,534</u>
Permanently restricted net assets		
Contributions	850	2,070
Increase in permanently restricted net assets	<u>850</u>	<u>2,070</u>
Increase in net assets	161,153	55,454
Net assets – beginning of year	711,018	655,564
Net assets – end of year	<u>\$ 872,171</u>	<u>\$ 711,018</u>

See notes to financial statements.

Ochsner Clinic Foundation and Subsidiaries

Consolidated Statements of Cash Flows
(In Thousands)

	Year Ended December 31,	
	2017	2016
	<i>(As Adjusted)</i>	
Operating activities		
Increase in net assets	\$ 161,153	\$ 55,454
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Pension-related changes other than net periodic pension costs	(2,674)	26,449
Depreciation and amortization	128,098	115,832
Provision for bad debts	87,789	88,454
Non-cash portion of loss on early extinguishment of debt	8,793	3,196
Amortization of deferred financing costs and debt premiums and discounts	(591)	498
Income (loss) from equity-method investments, net of cash received	721	(62)
Net realized and unrealized gains on investments	(88,705)	(42,653)
Gain on contribution of property to joint venture	(195)	(6,994)
Other, net	(850)	(2,070)
Changes in operating assets and liabilities, net of acquisitions:		
Patient accounts receivable	(84,490)	(115,525)
Other current and non-current assets	(27,962)	(41,110)
Accounts payable	38,924	1,189
Accrued expenses and other liabilities	27,332	(17,475)
Net cash provided by operating activities	<u>247,343</u>	<u>65,183</u>
Investing activities		
Purchases of assets whose use is limited and other investments	(389,924)	(256,336)
Sales and maturities of assets whose use is limited and other investments	339,601	192,980
Capital expenditures	(228,542)	(166,159)
Acquisition of businesses, net of cash acquired	(30,816)	-
Other	313	(948)
Net cash used in investing activities	<u>(309,368)</u>	<u>(230,463)</u>
Financing activities		
Repayment of bonds payable and long-term debt	(323,471)	(175,183)
Proceeds from long-term borrowings	458,024	174,369
Payments of debt financing costs	(4,288)	(2,229)
Payments on capital lease obligations	(4,258)	(2,981)
Proceeds from contributions restricted for long-term investments	850	2,070
Net cash provided by (used in) financing activities	<u>126,857</u>	<u>(3,954)</u>
Net increase (decrease) in cash and cash equivalents	64,832	(169,234)
Cash and cash equivalents – beginning of year	121,569	290,803
Cash and cash equivalents – end of year	<u>\$ 186,401</u>	<u>\$ 121,569</u>

See notes to financial statements.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2017

1. Summary of Significant Accounting Policies

Organization

Ochsner Clinic Foundation (OCF or Ochsner) d/b/a Ochsner Health System (OHS), located in New Orleans, Louisiana, is a not-for-profit institution that, either directly or through its fully owned subsidiaries, owns and operates an acute care hospital known as Ochsner Medical Center (OMC), an 11-story clinic building, a 143-room hotel, and related medical facilities located on a main campus in Jefferson Parish at the western end of New Orleans. OCF also owns 100% of the outstanding common stock of Ochsner System Protection Company (OSPC), a captive insurance company domiciled in Louisiana. OCF owns Ochsner Medical Center West Bank and Ochsner Baptist Medical Center, which are operated as remote campuses of OMC. It also owns and operates health centers throughout southeast Louisiana; owns a hospital in Baton Rouge, Louisiana, that operates as Ochsner Medical Center Baton Rouge; owns a hospital in Slidell, Louisiana, that operates as Ochsner Medical Center – North Shore; owns a hospital in Kenner, Louisiana, that operates as Ochsner Medical Center – Kenner; operates a hospital in Raceland, Louisiana, known as Ochsner St. Anne General Hospital; and owns several fitness centers that operate as Ochsner Fitness Center. OCF also provides management assistance and support for a hospital in Houma, Louisiana, known as Leonard J. Chabert Medical Center (Chabert); for a hospital in Luling, Louisiana, known as St. Charles Parish Hospital (SCPH); for a hospital in Chalmette, Louisiana, known as St. Bernard Parish Hospital (SBPH); and for a hospital in Bay St. Louis, Mississippi, known as Hancock Medical Center (Hancock).

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Prior to December 31, 2017, OHS was a not-for-profit, non-stock membership corporation and the parent company of OCF. Effective December 31, 2017, OHS was merged with and into OCF, with OCF as the surviving entity. Ochsner Clinic Foundation still operates under the trade name of Ochsner Health System. As a result of the merger, the 2016 OCF consolidated financial statements presented as prior year information in the 2017 consolidated financial statements mirror the amounts originally presented in the 2016 OHS consolidated financial statements. The amounts below display the changes compared to the 2016 OCF consolidated audit report (in thousands):

	Year Ended	
	December 31, 2016	
	OCF as	
	Originally	OCF as
	Reported	Adjusted
Total assets	\$ 2,303,785	\$ 2,350,839
Total liabilities	1,575,767	1,639,821
Total net assets	728,018	711,018
Total unrestricted revenues	2,814,370	2,767,793
Total operating expenses	2,756,973	2,717,407
Total operating income	57,397	50,386
Excess of revenues over expenses	36,139	29,130

Basis of Presentation and Principles of Consolidation

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP). The consolidated financial statements include the accounts of Ochsner and its wholly owned subsidiaries.

All intercompany accounts and transactions have been eliminated upon consolidation. The assets of any member of the consolidated group may not be available to meet the obligations of other members in the group, except as disclosed in Notes 7, 8, and 9.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include investments with a maturity of three months or less when purchased, excluding amounts whose use is limited by board designation, under bond indenture agreements, or under self-insurance agreements.

Inventories

Inventories are stated at the lower of first-in, first-out cost or market value.

Pledges Receivable

Unconditional promises to give are recognized as revenues at their fair values in the period received. Pledges receivable are recorded net of necessary discounts and allowances. The current portion of pledges receivable is recorded in accounts receivable other and the non-current portion is recorded in other assets in the consolidated balance sheets.

Pledges receivable as of December 31 are expected to be realized as follows (in thousands):

	<u>2017</u>	<u>2016</u>
In one year or less	\$ 7,772	\$ 11,302
Between one and five years	22,103	13,217
Greater than five years	7,519	11,761
	<u>37,394</u>	<u>36,280</u>
Less discount (ranging from 0.72%–4.25% at December 31, 2017 and 2016) and allowance for uncollectible pledges	<u>(3,270)</u>	<u>(2,478)</u>
Pledges receivable – net	<u>\$ 34,124</u>	<u>\$ 33,802</u>

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Investments

Investments held by Ochsner are included in assets limited as to use in the consolidated balance sheets. Substantially all of Ochsner's investments are designated as other-than-trading investments. Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated balance sheets. Investments also include investments in private equity funds, hedge funds, real estate funds, offshore fund vehicles, and funds of funds structured as limited liability corporations or partnerships or trusts. These investments are termed alternative investments in the notes to the consolidated financial statements and are accounted for under the equity method, which approximates fair value. These funds invest in certain types of financial instruments, including, among others, futures and forward contracts, options, and securities sold not yet purchased, intended to hedge against changes in the market value of investments. These financial instruments, which involve varying degrees of risk, may result in loss due to changes in the market (market risk).

Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments, other than alternative investments, are excluded from excess of revenues over expenses. If management believes a decline in the value of a particular investment is temporary, the decline is included in change in net unrealized gains (losses) excluding alternative investments on the consolidated statements of changes in net assets.

If the decline is evaluated as being other than temporary, the carrying value of the investment is written down and an impairment loss is recorded in non-operating gains and losses in the consolidated statements of operations. Ochsner did not record impairment losses on investment securities for the year ended December 31, 2017. Ochsner recorded impairment losses on investment securities of approximately \$1.6 million for the year ended December 31, 2016.

Assets Limited as to Use

Assets limited as to use primarily include assets held by trustees under indenture agreements, self-insurance trust agreements, investments restricted by donors, and designated assets set aside by the Board of Trustees (the Board) primarily for future capital improvements, over which the Board retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities have been classified in the consolidated balance sheets as current assets.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Property – Net

Property improvements and additions are recorded at cost and capitalized and depreciated on the straight-line basis over the following estimated useful lives of the assets:

	<u>Years</u>
Land improvements	5–25
Buildings and building improvements	10–40
Leasehold improvements	12–20
Equipment, furniture, and fixtures	2–20

Impairment of Long-Lived Assets

Ochsner evaluates the carrying value of long-lived assets to be held and used when events and circumstances warrant such a review. The carrying value of a long-lived asset is considered impaired when the anticipated undiscounted cash flow from such asset is separately identifiable and is less than its carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair value of the long-lived asset. Fair value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risk involved. There were no impairment charges on long-lived assets recognized for the years ended December 31, 2017 or 2016.

Capitalization of Interest

Ochsner capitalizes interest expense on qualifying construction-in-progress expenditures based on an imputed interest rate estimating Ochsner's average cost of borrowed funds. Such capitalized interest becomes part of the cost of the related asset and is depreciated over its estimated useful life. Capitalized interest costs totaled approximately \$4.6 million and \$2.2 million for the years ended December 31, 2017 and 2016, respectively.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Goodwill and Intangible Assets

Goodwill and intangible assets, consisting primarily of trade name and employment contracts, were recorded mainly as a result of the merger of Alton Ochsner Medical Foundation with Ochsner Clinic LLC in 2001, which resulted in the creation of OCF. Goodwill represents the excess of the fair value of the consideration conveyed in the acquisition over the fair value of net assets acquired. Goodwill and indefinite-lived intangible assets arising from business combinations are not amortized, but rather are tested for impairment at least annually at the reporting unit level. Impairment is the condition that exists when the carrying amount of goodwill or intangible assets exceeds its implied fair value. Additional impairment assessments may be performed on an interim basis if OCF encounters events or changes in circumstances that would indicate that it is more likely than not that the carrying value of goodwill or intangible assets has been impaired. OCF has selected October 31 as its annual testing date and has determined that its reporting unit is the consolidated entity.

For purposes of the October 31, 2017 and 2016 annual impairment tests, OCF applied the optional provisions of Accounting Standards Update (ASU) No. 2011-08, *Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment*, which provides for a qualitative impairment analysis. A qualitative impairment analysis concluded that it was more likely than not that the fair value exceeded the carrying value of the applicable reporting units. Therefore, the two-step impairment analysis was not required, and no impairment charge was recorded as of the October 31, 2017 or 2016 annual impairment tests.

Due to the merger of OHS with and into OCF, OCF performed an additional quantitative impairment assessment as of December 31, 2017. The first step in the impairment process is to estimate the fair value of the reporting unit and then compare it to the carrying value, including goodwill. If the fair value exceeds the carrying value, no further action is required and no impairment loss is recognized. OCF determined that the use of the income and market approaches were the most appropriate methods of measuring fair value of the reporting units. These are considered Level 3 valuations in the valuation hierarchy described in Note 2.

Under the income approach, fair value is estimated using a discounted cash flow analysis. Under the market approach, fair value is estimated using a guideline company method and a comparable transaction method. Both the income approach and the market approach require significant assumptions to determine the fair value of each reporting unit. The significant assumptions used

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

in the income approach include estimates of future revenues, profits, capital expenditures, working capital requirements, operating plans, industry data, and an appropriate discount rate for each reporting unit. The significant assumptions used in the market approach include the determination of appropriate market comparables and estimated multiples of net revenue and earnings before interest, taxes, depreciation, and amortization. OCF engaged a third-party valuation firm to assist in these fair value calculations. OCF performed Step 1 of the impairment test using a quantitative impairment analysis as of December 31, 2017, and concluded the fair value exceeded the carrying value, and no further action was required.

Deferred Revenue

Ochsner engages in research activities funded by contracts from U.S. Government agencies and other private sources. Revenue related to grants and contracts is recognized as the related costs are incurred. Amounts received from grant and contract sponsors for which Ochsner has not yet fulfilled its obligations are included in deferred revenue in the accompanying consolidated balance sheets and recognized in future periods once the obligations have been satisfied.

Deferred revenue also includes amounts related to Medicaid supplemental payments which are yet to be recognized as revenue, as well as payments received in advance of services rendered for Ochsner's electronic health records (EHR) services agreements (see Note 14).

In June 2017, Ochsner entered into a series of agreements with a third-party vendor for the construction, installation, and management of energy facilities used to process and distribute chilled water and steam at OMC. Under the terms of a concession agreement, the third-party vendor obtained the right to use, control, and manage the energy assets and associated building space. Ochsner, in turn, purchases chilled water and steam generated from the third-party vendor. As part of the concession agreement, Ochsner received a payment of approximately \$20.9 million from the third-party vendor. Ochsner recorded this payment as deferred revenue within the consolidated balance sheets. The associated revenue is being amortized and recognized over the life of the agreement and is included in other operating revenue in the accompanying consolidated statements of operations.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Deferred Financing Costs

In connection with the issuance of bonds and long-term debt, certain financing costs are being amortized over the respective lives of the bonds and long-term debt. These costs are approximately \$12.3 million and \$11.5 million net of accumulated amortization at December 31, 2017 and 2016, respectively, and are included as a reduction to bonds payable and long-term debt in the accompanying consolidated balance sheets.

Derivative Financial Instruments

Ochsner utilizes interest rate swap agreements to manage its interest rate exposure. Changes in the fair value of Ochsner's swaps not designated as hedges are recorded as non-operating gains and losses in the consolidated statements of operations. Changes in the fair value of Ochsner's swaps that are designated as hedges are recorded as changes in unrestricted net assets in the consolidated statements of changes in net assets.

Estimated Workers' Compensation, Professional and General Liability, and Employee Health Claims

Ochsner is self-insured for workers' compensation, professional and general liability, and employee health claims. The provisions for estimated workers' compensation, professional liability, and employee health claims include estimates for the ultimate costs for both reported claims and claims incurred but not reported. These estimates incorporate Ochsner's past experience, as well as other considerations, including the nature of claims, industry data, relevant trends, and the use of actuarial information.

Accounting for Pension and Other Postretirement Plans

Ochsner recognizes the overfunded or underfunded status of its pension and other postretirement plans as an asset or liability in its consolidated balance sheets. Changes in the funded status of the pension and other postretirement plans are reported as a change in unrestricted net assets presented below the excess of revenues over expenses financial statement line item in the consolidated statement of changes in net assets in the year in which the changes occur.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Reinsurance

OSPC relies on reinsurance to limit its retained property insurance risk. In entering into reinsurance agreements, management considers a variety of factors, including the creditworthiness of reinsurers. In preparing its financial statements, management makes estimates of amounts receivable from reinsurers, which includes consideration of amounts, if any, estimated to be uncollectible by management based on an assessment of factors including an assessment of the creditworthiness of the reinsurers. OSPC cedes 100% of the underlying risk, and as a result, OSPC retains no insurance risk. However, OSPC is not relieved of its primary obligation and is subject to credit risk of its reinsurers. OSPC's last reinsurance contract ended on May 31, 2014. Its expiration coincided with the expiration of the last policy written by OSPC.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by Ochsner has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by Ochsner in perpetuity.

Consolidated Statements of Operations

For purposes of presentation, all revenues and expenses are reported as operating except for investment income, the loss from early extinguishment of debt, and other gains and losses – net, which are reported as non-operating.

Excess of Revenues Over Expenses

The consolidated statements of operations include excess of revenues over expenses, which represents Ochsner's performance indicator. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on other-than-trading investments, contributions used to acquire property and equipment, and pension-related changes other than net periodic pension costs.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Net Patient Service Revenue

Net patient service revenue is recognized as services are performed and is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Amounts Ochsner receives for treatment of patients covered by governmental programs such as Medicare and Medicaid and other third-party payors such as health maintenance organizations, preferred provider organizations, and other private insurers are generally less than Ochsner's established billing rates. Additionally, to provide for accounts receivable that could become uncollectible in the future, Ochsner establishes an allowance for doubtful accounts to reduce the carrying value of such receivables to their estimated net realizable value. Third-party accounts are pursued until all payments and adjustments are posted to the patient account. For those accounts with a patient balance after third-party liability is finalized or accounts for uninsured patients, the patient receives statements and collection letters. Patients who express an inability to pay are reviewed for potential sources of financial assistance, including Ochsner's charity care policy. If the patient is deemed unwilling to pay, the account is written off as bad debt and transferred to an outside collection agency for additional collection efforts.

Accordingly, the revenues and accounts receivable reported in Ochsner's consolidated financial statements are recorded at the net amount expected to be received. Retroactively calculated contractual adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and are adjusted as final settlements are determined.

During the current year, Ochsner determined that approximately \$44.4 million was recognized in 2016 as net patient service revenues and offsetting benefits expenses related to Ochsner's self-insured employees, which should have been eliminated in consolidation. Management evaluated the impact of the adjustment, which had no impact to operating income or excess of revenues over expenses, and determined that the amount was immaterial to the consolidated financial statements. As such, the prior year amounts have been adjusted to conform with the current year presentation.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Charity Care

Ochsner provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Records of charges foregone for services and supplies furnished under the charity care policy are maintained to identify and monitor the level of charity care provided. Because Ochsner does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Ochsner estimates its costs of care provided under its charity care programs by applying a ratio of direct and indirect costs to charges to the gross foregone charges associated with providing care to charity patients. Ochsner's gross charity care charges include only services provided to patients who are unable to pay and qualify under Ochsner's charity care policies. The ratio of cost to charges is calculated based on Ochsner's total expenses divided by gross patient revenue. During the years ended December 31, 2017 and 2016, the estimated costs incurred by Ochsner to provide care to patients who met certain criteria under its charity care policy were approximately \$29.2 million and \$42.2 million, respectively.

Community Benefit

Since December 2010, Ochsner and four other health care providers have formed nonprofit organizations with the purpose to create a vehicle to provide services to low-income and needy patients. Expenditures recorded by Ochsner to fund the organizations for the years ended December 31, 2017 and 2016, were approximately \$28.4 million and \$40.7 million, respectively, and are included in other operating expenses in the consolidated statements of operations.

Provision and Allowance for Doubtful Accounts

To provide for accounts receivable that could become uncollectible in the future, Ochsner establishes an allowance for doubtful accounts to reduce the carrying value of such receivables to their estimated net realizable value. The primary uncertainty lies with uninsured patient receivables and deductibles, co-payments, or other amounts due from individual patients. Payment pressure from managed care/indemnity payors also affects Ochsner's provision for doubtful accounts.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

There are various factors that can impact collection trends, such as changes in the economy, which in turn have an impact on unemployment rates and the number of uninsured and underinsured patients, the volume of patients through Ochsner's emergency departments, the increased burden of co-payments and deductibles to be made by patients with insurance, and business practices related to collection efforts. These factors continuously change and can have an impact on collection trends and the estimation process.

Ochsner has an established process to determine the adequacy of the allowance for doubtful accounts that relies on a number of analytical tools and benchmarks to arrive at a reasonable allowance. No single statistic or measurement determines the adequacy of the allowance for doubtful accounts. Some of the analytical tools that Ochsner utilizes include, but are not limited to, historical cash collection experience, revenue trends by payor classification, and revenue days in accounts receivable. Accounts receivable are written-off after collection efforts have been followed in accordance with Ochsner's policies.

Other Operating Revenue

Other operating revenue includes pharmacy revenue, rental revenue, durable medical equipment rentals and sales, gift shop revenues, EHR incentive payments, revenue from joint operating agreements and management agreements, income from equity-method investees, fitness center revenue, hotel revenue, and revenues from other miscellaneous sources.

HIT Incentive Payments and Other Benefits

Beginning in 2012, Ochsner achieved compliance with certain of the health information technology (HIT) requirements under the American Recovery and Reinvestment Act of 2009. As a result, Ochsner recognized approximately \$4.3 million and \$9.4 million in other operating revenue in the accompanying consolidated statements of operations for 2017 and 2016, respectively, for EHR incentives related to Medicaid and Medicare programs. These incentives partially offset the operating expenses Ochsner has incurred and continues to incur from its investment in HIT systems. Ochsner did not have any accounts receivable related to these incentives at December 31, 2017. At December 31, 2016, Ochsner had approximately \$0.6 million included in accounts receivable other in the accompanying consolidated balance sheet related to these incentives. Ochsner accounts for EHR incentive payments under the grant accounting model as grants related to income.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Medicare and Medicaid EHR incentive payments are recognized as revenue after Ochsner has determined it is reasonably assured to comply with the meaningful use criteria over the entire applicable compliance period. Ochsner's compliance with the meaningful use criteria is subject to audit by the federal government.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received, which is then treated as cost. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations as net assets released from restrictions. Contributions for which restrictions are met in the same period in which the unconditional promise to give is received are recorded as unrestricted revenue.

Fair Value of Financial Instruments Other Than Investments

The following methods and assumptions were used by Ochsner in estimating the fair value of its financial instruments:

Current Assets and Liabilities

Ochsner considers the carrying amounts of financial instruments classified as current assets and liabilities to be a reasonable estimate of their fair values.

Bonds Payable

The fair values of Ochsner's revenue bonds are based on currently traded values of similar financial instruments as disclosed in Note 8.

Notes Payable and Long-Term Debt

Ochsner considers the carrying value of its notes payable and long-term debt to approximate fair value at December 31, 2017, due to the variable nature of the interest rate or based on a comparison of its fixed rates to current market rates.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Income Taxes

Ochsner and its subsidiaries qualify as tax-exempt organizations under Section 501(a) and are described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal and state income taxes. Management annually reviews its tax positions and has determined that there are no material uncertain tax positions that require recognition in the accompanying consolidated balance sheets. The statute of limitations remains open for tax years 2014 through 2017 in Ochsner's main tax jurisdictions. The Tax Cuts and Jobs Act (Act) was enacted on December 22, 2017. The Act reduces the U.S. federal corporate tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that was previously tax deferred and creates new taxes on certain foreign sourced earnings. For tax-exempt entities, the Act also requires organizations to categorize certain fringe benefit expenses as a source of unrelated business income, pay an excise tax on remuneration above certain thresholds that is paid to executives by the organization, and report income or loss from unrelated business activities on an activity-by-activity basis, among other provisions. Certain regulatory guidance provides for a measurement period of up to one year during which the accounting for the tax effects of the Act may be completed. Ochsner may record further adjustments in future periods upon obtaining, preparing, or analyzing additional information about facts and circumstances that existed as of the date of enactment that would have affected the income tax effects initially reported. Ochsner will continue to revise and refine the calculations as additional IRS guidance is issued.

Concentration of Credit Risk

Ochsner grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements.

Risks and Uncertainties

Ochsner's business could be impacted by continuing price pressure on new and renewal business, Ochsner's ability to effectively control health care costs, additional competitors entering Ochsner's markets, and federal and state legislation in the area of health care reform. Changes in these areas could adversely impact its operations in the future.

Reclassification

Certain prior year amounts have been reclassified to conform to the 2017 presentation. These reclassifications had no impact on total assets, liabilities, or changes in net assets.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements

In May 2015, the FASB issued ASU 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. Accounting Standards Codification Topic (ASC) 820, *Fair Value Measurement*, permits a reporting entity, as a practical expedient, to measure the fair value of certain investments using the net asset value per share of the investment. ASU 2015-07 removes the requirement to categorize investments within the fair value hierarchy for which fair values are measured using the net asset value per share practical expedient. It also limits disclosures to investments for which the entity has elected to measure the fair value using the practical expedient. Ochsner adopted the provisions of ASU 2015-07 effective January 1, 2017. The adoption resulted in disclosure changes as discussed in Note 10.

Pending Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU 2014-09 provides for a single comprehensive principles-based standard for the recognition of revenue across all industries through the application of the following five-step process:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Among other provisions and in addition to expanded disclosure about the nature, amount, timing, and uncertainty of revenue, as well as certain additional quantitative and qualitative disclosures, ASU 2014-09 changes the health care industry specific presentation guidance under ASU 2011-07, *Health Care Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. The provisions of ASU 2014-09 were effective for OHS starting January 1, 2018, including interim periods within that reporting period. Early application is permitted only for annual periods beginning after December 15, 2016, including interim periods within that reporting period.

Ochsner has evaluated the requirements of ASU 2014-09 to ensure that processes, systems, and internal controls are in place to collect the necessary information to implement the standard effective January 1, 2018. Ochsner is also in the process of drafting the new disclosures required post-implementation. Ochsner used a full retrospective method of application to adopt ASU 2014-09 on January 1, 2018. For patient service revenue, net of contractual allowances and discounts, Ochsner used a portfolio approach to apply the new model to classes of payors with similar characteristics based on historical payment trends. For other operating revenue, Ochsner reviewed the revenue streams within this category and analyzed contracts for material classes of transactions to determine the application of the revenue recognition criteria.

Adoption of ASU 2014-09 will result in changes to Ochsner's presentation and disclosure of revenue related to uninsured or underinsured patients. Prior to the adoption of ASU 2014-09, a significant portion of Ochsner's provision for doubtful accounts related to self-pay patients, as well as co-pays and deductibles owed to Ochsner by patients with insurance in patient service revenue, net of contractual allowances and discounts. Under ASU 2014-09, the estimated uncollectible amounts due from these patients are generally considered a direct reduction to net operating revenues and, correspondingly, result in a material reduction in the amounts presented separately as provision for doubtful accounts.

Ochsner also assessed the impact of the new standard on various reimbursement programs that represent variable consideration, including settlements with third-party payors, disproportionate share payments, supplemental state Medicaid programs, and other reimbursement programs in which Ochsner hospitals participate. Industry guidance is continuing to develop around these issues, and any conclusions in the final industry guidance that is inconsistent with Ochsner's application could result in changes to Ochsner's expectations regarding the impact that this new

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

accounting standard could have on Ochsner's financial statements. If changes were to be warranted, quarterly reporting might be impacted, but we do not believe it would have a significant impact on Ochsner's financial position. Final drafts of industry guidance on these and other reimbursement programs unique to the health care industry are expected later in 2018. Ochsner is monitoring the development of such guidance.

While the adoption of ASU 2014-09 will change the presentation of net operating revenues in Ochsner's consolidated statements of operations and will impact certain disclosures, it will not materially impact its consolidated financial position, results of operations, or cash flows. There was no cumulative effect of a change in accounting principle recorded related to the adoption of ASU 2014-09 on January 1, 2018.

In January 2016, the FASB issued ASU 2016-01, *Financial Instrument – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01 requires that investments in equity securities, and other ownership interests in an entity that do not result in consolidation and are not accounted for under the equity method, be measured at fair value at the end of each reporting period, and the resulting changes in fair value be recognized in excess of revenues over expenses. Ochsner will no longer be able to recognize unrealized holding gains and losses on equity securities it classifies today as available for sale in other changes in unrestricted net assets. The provisions of ASU 2016-01 are effective for Ochsner starting January 1, 2018, including interim periods within that reporting period. The adoption of ASU 2016-01 will result in a reclassification of unrealized holding gains and losses on equity securities from other changes in unrestricted net assets to excess of revenues over expenses.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires companies that lease assets to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in its balance sheet. The pronouncement will also require additional disclosures about the amount, timing, and uncertainty of cash flows arising from leases. The provisions of ASU 2016-02 are effective for Ochsner starting January 1, 2019, including interim periods within that reporting period, and early adoption is permitted. Management is currently evaluating the impact of this pronouncement on OHS' consolidated financial statements.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. Under the new standard, the presentation of financial information for not-for-profits, specifically with respect to liquidity, financial performance, and cash flows, will be simplified and provide more relevant information to donors, grantors, creditors, and other users. This includes areas such as net asset classification, investment return, expenses, liquidity and availability of resources, and a change in the presentation of operating cash flows. The provisions of ASU 2016-14 were effective for Ochsner for the fiscal year starting January 1, 2018, and for interim periods starting January 1, 2019, and early adoption is permitted. Management is currently evaluating the impact of this pronouncement on Ochsner's consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, which is intended to reduce diversity in practice on how certain transactions are classified in the statement of cash flows. The new standard addresses eight issues: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; distributions received from equity method investments; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The provisions of ASU 2016-15 are effective for Ochsner starting January 1, 2018, including interim periods within that reporting period, and early adoption is permitted. Management is currently evaluating the impact of this pronouncement on Ochsner's consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The amendments in ASU 2017-07 require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. It also requires the other components of net periodic pension cost and net periodic postretirement benefit cost to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations. The provisions of ASU 2017-07 are effective for Ochsner starting January 1, 2019, including interim periods within that reporting period, and early adoption is permitted. Management is currently evaluating the impact of this pronouncement on Ochsner's consolidated financial statements.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Assets Limited as to Use and Related Fair Value Measurements and Disclosures

Accounting Standards Codification (ASC) 820, *Fair Value Measurement*, establishes a common definition for fair value to be applied to U.S. GAAP requiring use of fair value, establishes a framework for measuring fair value, and expands disclosures about such fair value measurements. ASC 820 establishes a hierarchy for ranking the quality and reliability of the information used to determine fair values. ASC 820 requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1 – Unadjusted quoted market prices in active markets for identical assets or liabilities.

Level 2 – Unadjusted quoted prices in active markets for similar assets or liabilities, unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices are observable for the asset or liability.

Level 3 – Unobservable inputs for the asset or liability.

Ochsner endeavors to utilize the best available information in measuring fair value. Financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement. Transfers into and transfers out of the hierarchy levels are recognized as if they had taken place at the end of the reporting period. In the year ended December 31, 2017, a publicly-traded security was de-listed; therefore, at December 31, 2017, this is accounted for as an alternative investment and is not included in the fair value tables below. There were no transfers between Level 1 and Level 2 in the year ended December 31, 2016.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Assets Limited as to Use and Related Fair Value Measurements and Disclosures
(continued)**

Assets and Liabilities Measured at Fair Value

Recurring Fair Value Measurements

The fair values of assets measured at estimated fair value on a recurring basis are estimated as described in the preceding section. These estimated fair values and their corresponding fair value hierarchy in accordance with ASC 820 are summarized as follows (in thousands):

	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1) ^(a)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Estimated Fair Value
December 31, 2017				
Money market funds	\$ 113,938	\$ –	\$ –	\$ 113,938
Fixed income investments	264,626	–	–	264,626
Marketable equity securities	126,981	–	–	126,981
Diversifiers	101,232	–	–	101,232
Natural resources and other	34,139	–	–	34,139
Total	\$ 640,916	\$ –	\$ –	\$ 640,916
December 31, 2016				
Money market funds	\$ 58,464	\$ –	\$ –	\$ 58,464
Fixed income investments	244,057	–	–	244,057
Marketable equity securities	166,667	–	–	166,667
Diversifiers	69,344	–	–	69,344
Natural resources and other	31,345	–	–	31,345
Total	\$ 569,877	\$ –	\$ –	\$ 569,877

^(a) Valuation of these securities classified as Level 1 is based on unadjusted quoted prices in active markets that are readily and regularly available. Investments classified as Level 1 include mutual funds that are publicly traded.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Assets Limited as to Use and Related Fair Value Measurements and Disclosures (continued)

Alternative investments and other investments of approximately \$325.8 million and \$265.7 million at December 31, 2017 and 2016, respectively, are not included in these tables since they are accounted for using the equity method of accounting and not measured at fair value. Real estate investments of approximately \$7.6 million and \$5.7 million at December 31, 2017 and 2016, respectively, are not included in these tables since they are accounted for at cost.

Investment income and other gains and losses are classified as non-operating and comprise interest and dividend income of approximately \$17.2 million and \$11.7 million (net of expenses of approximately \$1.7 million and \$1.5 million for the years ended December 31, 2017 and 2016, respectively) and realized net gains (losses) on sales of securities of approximately \$29.9 million and \$(4.1) million for 2017 and 2016, respectively. Unrealized gains (losses) on alternative investments were approximately \$32.3 million and \$(10.2) million during 2017 and 2016, respectively. Unrealized gains (losses) on investments other than alternative investments are recorded at fair value and are included in other changes in unrestricted net assets.

3. Net Patient Service Revenue

Net patient service revenue is recognized when services are provided. Ochsner has agreements with third-party payors that provide for payments at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered.

A summary of the significant payment arrangements with major third-party payors follows:

Medicare and Medicaid

Inpatient acute care services and defined capital costs related to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Medicare inpatient rehabilitation services are also paid at prospectively determined rates per discharge, based on a patient classification system. Psychiatric services rendered to Medicare beneficiaries are reimbursed on a prospectively determined rate per day. Outpatient services to Medicare beneficiaries are paid on a prospectively determined amount per procedure. Medicare skilled nursing care is paid on a prospectively determined amount per diem based on a patient classification system. The Medicare program's share of indirect medical education costs is reimbursed based on a stipulated formula.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue (continued)

The Medicare program's share of direct medical education costs is reimbursed based on a prospectively determined amount per resident. Inpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined per diem rates. Outpatient services rendered to Medicaid program beneficiaries are reimbursed on a cost basis subject to certain limits.

Ochsner records retroactive Medicare and Medicaid settlements based upon estimates of amounts that are ultimately determined through annual cost reports filed with and audited by the fiscal intermediary. The difference between estimated and audited settlements is recorded as an adjustment to net patient service revenue in the year a determination is made. The favorable resolution of reimbursement issues under appeal by Ochsner is reported as an increase in net patient service revenue in the year the issue is resolved.

As a result of retroactive settlements of certain prior year cost reports, Ochsner recorded changes in estimates during the years ended December 31, 2017 and 2016. As a result of changes in prior year estimates, net patient service revenues increased approximately \$1.9 million and \$1.6 million in 2017 and 2016, respectively.

Medicaid Supplemental Payment Program

Since December 2010, Ochsner's hospitals and eight other hospitals (Baton Rouge General Medical Center, CHRISTUS Schumpert Health System, CHRISTUS St. Frances Cabrini Hospital, CHRISTUS St. Patrick Hospital, Lakeview Regional Medical Center, Women's & Children's Hospital, Rapides Regional Medical Center, and Tulane University Hospital and Clinic) entered into collaborations with the State and several units of local government in Louisiana (Jefferson Parish Hospital Service District No. 2, Natchitoches Hospital District No. 1, Jefferson Parish Human Services Authority, Terrebonne Parish Hospital Service District #1, Southern Regional Medical Corporation, Hospital Service District No. 3 of the Parish of Allen, The Parish Hospital Service District for the Parish of Orleans – District A, Savoy Medical Center, Hospital Service District No. 1 of Iberia Parish, St. Tammany Parish Hospital Service District No. 1, St. Tammany Parish Hospital Service District No. 2, and Vermilion Parish Hospital Service District #2) to more fully fund the Medicaid program (the Program) to ensure services remain available to low-income and needy patients in the respective communities.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue (continued)

These collaborations enable the governmental entities to increase support for the Uncompensated Care Cost (UCC) program for hospital services to the Medicaid and uninsured populations, the Medicaid Upper Payment Limits (UPL) programs for hospital and physician services to the Medicaid fee-for-service population, and the Full Medicaid Payment (FMP) program for physician services to the Medicaid managed care population. Each State's UCC and UPL methodology must comply with its State plan and be approved by the Centers for Medicare & Medicaid Services (CMS). Under the UCC and UPL programs, federal matching funds are not available for Medicaid payments that exceed a provider's individual UPL or UCC entitlement.

Under the FMP program, Medicaid Managed Care Organizations contracted to pay increased reimbursement for physician services that more closely aligns the reimbursement rates for the Medicaid managed care population with the equivalent total reimbursement rates for the Medicaid fee-for-service population.

In 2017 and 2016, Ochsner recognized approximately \$172.4 million and \$195.6 million, respectively, in net patient service revenue related to the Program and recorded accounts receivable of approximately \$2.2 million and \$15.1 million at December 31, 2017 and 2016, respectively. Such amounts are included in accounts receivable other in the accompanying consolidated balance sheets.

Humana Inc.

Ochsner entered into a provider contract with Humana Inc. to provide services for its commercial and senior members on a fee-for-service basis for physician services and at prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates for hospital services. Also, Ochsner provided services to approximately 35,000 senior members under a capitation contract for both physician and hospital services. Premium revenue from Humana Inc. under the capitation contract approximated \$298.8 million and \$286.2 million in 2017 and 2016, respectively, and is included in premium revenue in the accompanying consolidated statements of operations. Expenses for medical services to outside providers under the capitation contract approximated \$134.0 million and \$132.5 million in 2017 and 2016, respectively, and are included in medical services to outside providers in the accompanying consolidated statements of operations. Net revenue from Humana Inc. on a fee-for-service basis approximated \$208.5 million and \$197.7 million in 2017 and 2016, respectively, and is included in net patient service revenue in the accompanying consolidated statements of operations.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue (continued)

Managed Care

Ochsner has also entered into contractual arrangements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. Inpatient and outpatient services rendered to managed care subscribers are reimbursed at prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Ochsner recognizes net patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients who are not eligible for charity care, Ochsner recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). Based on historical experience, a significant portion of Ochsner's uninsured and underinsured patients will be incapable or reluctant to pay for the services provided. Therefore, Ochsner records a significant provision for bad debts in the period the services are provided related to patient receivables and deductibles, co-payments, or other amounts due from individual patients who have been deemed unwilling to pay.

The table below shows the sources of patient service revenue (net of contractual allowances and discounts), before the provision for bad debts, for the years ended December 31 (in thousands).

	<u>2017</u>	<u>2016</u>
Government agencies	\$ 869,350	\$ 797,771
Patients	22,894	29,405
Managed care/indemnity	1,489,111	1,413,867
Patient service revenue, net of contractual allowances and discounts	<u>\$ 2,381,355</u>	<u>\$ 2,241,043</u>

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Patient Accounts Receivable

At December 31, Ochsner's patient accounts receivable balances were due from the following sources (in thousands):

	<u>2017</u>	<u>2016</u>
Managed care/indemnity	\$ 199,894	\$ 186,105
Government agencies	78,572	87,735
Patients	18,005	25,330
Total	<u>296,471</u>	<u>299,170</u>
Less allowance for doubtful accounts	<u>(47,172)</u>	<u>(46,572)</u>
Patient accounts receivable – net	<u>\$ 249,299</u>	<u>\$ 252,598</u>

The allowance for doubtful accounts due from patients was 3.5% and 4.5% of the accounts receivable balance at December 31, 2017 and 2016, respectively. The allowance for doubtful accounts due from managed care/indemnity payors was 11.8% and 10.4% of the accounts receivable balance at December 31, 2017 and 2016, respectively.

A summary of activity in the allowance for doubtful accounts is as follows (in thousands):

	<u>Balance at Beginning of Year</u>	<u>Provision for Doubtful Accounts</u>	<u>Accounts Written Off, Net of Recoveries</u>	<u>Balance at End of Year</u>
Year ended December 31, 2016	\$ 52,914	\$ 88,454	\$ (94,796)	\$ 46,572
Year ended December 31, 2017	46,572	87,789	(87,189)	47,172

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Property – Net

Ochsner’s investment in property at December 31 is as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Land and improvements	\$ 107,014	\$ 97,599
Buildings and leasehold improvements	832,485	745,580
Equipment, furniture, and fixtures	1,142,190	1,058,700
Construction-in-progress	124,664	99,906
Total property – at cost	<u>2,206,353</u>	<u>2,001,785</u>
Less accumulated depreciation	1,278,374	1,180,093
Property – net	<u>\$ 927,979</u>	<u>\$ 821,692</u>

Depreciation and amortization expense totaled approximately \$128.1 million and \$115.8 million for the years ended December 31, 2017 and 2016, respectively.

At December 31, 2017 and 2016, Ochsner has purchase commitments totaling approximately \$105.7 million and \$87.0 million, respectively, toward additional capital expenditures.

Ochsner leases certain software and equipment under capital leases. Capital lease assets are included in equipment, furniture, and fixtures in the accompanying consolidated balance sheets as of December 31 and are as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Software and equipment	\$ 26,158	\$ 23,668
Accumulated amortization	(10,322)	(7,675)
Net carrying value of capital lease assets	<u>\$ 15,836</u>	<u>\$ 15,993</u>

Amortization expense applicable to the capital lease asset is included in depreciation and amortization in the accompanying consolidated statements of operations.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Goodwill and Intangible Assets

On August 31, 2001, Alton Ochsner Medical Foundation and Ochsner Clinic LLC effected a merger transaction resulting in the creation of OCF and the net assets of Ochsner Clinic LLC being acquired by Alton Ochsner Medical Foundation.

The cost to acquire Ochsner Clinic LLC was allocated to the assets acquired and liabilities assumed according to their estimated fair values. In addition, the carrying values of certain other assets and liabilities of Ochsner Clinic LLC were changed to reflect management's estimate of fair value under purchase accounting.

On May 2, 2016, Ochsner acquired 100% of the equity interest in Sculpting Center of New Orleans, LLC. As part of this transaction, Ochsner recorded approximately \$0.5 million of goodwill related to the acquisition.

On January 9, 2017, Ochsner completed the acquisition of Millennium Healthcare Management, Inc. (MHM). Approximately \$28.0 million of goodwill and approximately \$0.9 million of other intangible assets related to this acquisition are included in the December 31, 2017 balance sheet.

Amounts recorded as goodwill and other indefinite and definite-lived intangible assets as of December 31 are as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Goodwill	\$ 71,195	\$ 43,558
Trade name – intangible assets	\$ 11,433	\$ 11,433
Other – intangible assets	921	34
	<u>\$ 12,354</u>	<u>\$ 11,467</u>

7. Notes Payable

Ochsner has a loan agreement with a bank that provides a credit line with maximum borrowings of \$53.0 million. The line of credit currently expires on June 8, 2018. Borrowings under the arrangement are unsecured; however, Ochsner must meet certain financial covenants. Management believes Ochsner was in compliance with these covenants at December 31, 2017 and 2016. At December 31, 2017 and 2016, Ochsner had borrowings outstanding under this

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Notes Payable (continued)

arrangement of approximately \$52.4 million. The interest rate on outstanding borrowings is based on the London Interbank Offered Rate (LIBOR) and, consequently, fluctuates from month to month. The rate on outstanding indebtedness under this arrangement was 2.86% and 2.12% at December 31, 2017 and 2016, respectively. All amounts are classified as current at December 31, 2017 and 2016.

8. Bonds Payable

At December 31, bonds payable consisted of the following tax-exempt and taxable bonds (in thousands). The tax-exempt revenue bonds were issued by the Louisiana Public Facilities Authority (LPFA) on behalf of Ochsner. The taxable bonds were issued by Ochsner.

	<u>2017</u>	<u>2016</u>
Series 2017 tax-exempt bonds issued by the LPFA May 2017, due serially 2019–2037, then on term in 2042 and 2046, annual interest rates ranging from 4.00% to 5.00%	\$ 421,555	\$ –
Series 2016 tax-exempt bonds issued by the LPFA May 2016, due serially 2023–2036, then on term in 2041 and 2047, annual interest rates ranging from 3.00% to 5.00%	154,060	155,660
Series 2015 tax-exempt bonds issued by the LPFA August 2015, due serially 2016–2035, then on term in 2040 and 2047, annual interest rates ranging from 2.00% to 5.00%	110,775	112,815
Series 2015 taxable bonds issued June 2015, due in 2045, annual interest rate at 5.90%	252,820	252,820
Series 2007-A tax-exempt bonds issued by the LPFA September 2007, due serially 2009–2047, annual interest rates ranging from 5.00% to 5.50%	–	250,805
Series 2007-B tax-exempt bonds issued by the LPFA September 2007, due serially 2009–2047 annual interest rates ranging from 5.00% to 5.50%	–	53,445
Unamortized net bond premium	59,416	18,768
Total	<u>998,626</u>	<u>844,313</u>
Less deferred financing costs	9,801	8,875
Less current portion	2,095	7,030
Non-current portion of bonds payable	<u>\$ 986,730</u>	<u>\$ 828,408</u>

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Bonds Payable (continued)

All of the bonds included in the table above are general obligations of Ochsner. The security includes a pledge of all present and future accounts receivable of Ochsner and a mortgage of certain property.

Also, under the terms of the bond indenture, Ochsner is required to make certain deposits of principal and interest with a trustee. Such deposits are included with assets limited as to use in the consolidated financial statements. The bond indenture also places limits on the incurrence of additional borrowings by Ochsner and requires that it satisfy certain measures of financial performance as long as the bonds are outstanding. Management is not aware of any noncompliance with these requirements.

In May 2016, the Louisiana Public Facilities Authority issued tax-exempt revenue bonds in the amount of \$155.7 million under a loan agreement with Ochsner. Ochsner used the proceeds to pay the cost of refunding the Series 2011 bonds in the amount of \$150.0 million, resulting in a loss on extinguishment of approximately \$39.1 million.

In May 2017, the Louisiana Public Facilities Authority issued tax-exempt revenue bonds in the amount of \$421.6 million under a loan agreement with Ochsner. Ochsner used a portion of the proceeds to pay the cost of refunding the Series 2007-A and 2007-B bonds in the amounts of approximately \$246.6 million and \$52.7 million, respectively, resulting in a loss on extinguishment of approximately \$9.1 million. The remainder of the bonds are being used to provide funding for various Ochsner capital projects.

At December 31, 2017, scheduled repayments of principal and sinking fund installments to retire the bonds payable for the next five fiscal years are as follows (in thousands):

Years ending December 31:	
2018	\$ 2,095
2019	4,060
2020	5,590
2021	7,210
2022	7,580

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Bonds Payable (continued)

The estimated fair value of the Series 2007-A tax-exempt bonds, Series 2007-B tax-exempt bonds, Series 2015 tax-exempt bonds, Series 2015 taxable bonds, Series 2016 tax-exempt bonds, and Series 2017 tax-exempt bonds as of December 31, 2017 and 2016, is approximately \$1.1 billion and \$875.9 million, respectively. This fair value is based on quoted market prices for similarly rated health care revenue bond issues, a Level 2 input.

9. Long-Term Debt

A summary of long-term debt at December 31 is as follows (in thousands):

	2017	2016
Working capital note, due May 2026 (subject to six additional 5-year extensions), including accrued interest at rates varying from 1.12% to 1.80% during 2017 with a rate of 1.76% as of December 31, 2017	\$ 8,732	\$ 8,604
Note payable 4.61% Senior Secured Note, entered into March 2013, due March 2033	5,868	6,127
Note payable 5.26% Senior Secured Note, entered into December 2013, due December 2028	50,709	54,028
Promissory note entered into December 2013, due December 2020 with interest synthetically fixed at 3.97%	12,623	14,698
Note payable 5.09% Senior Secured Note, entered into July 2014, due August 2034	71,622	74,286
Promissory note entered into October 2014, due October 2021 with interest at 3.75%	17,600	19,067
Promissory note entered into September 2015, due September 2022 with interest synthetically fixed at 4.13%	24,000	27,000
Software and equipment loans, due varying dates in 2016–2019	341	3,131
Total long-term debt	191,495	206,941
Less deferred financing costs	2,470	2,658
Less unamortized discount	4	24
Less current portion	13,299	15,566
Non-current portion of long-term debt	\$ 175,722	\$ 188,693

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

St. Anne

On May 1, 2006, Ochsner entered into lease and management services agreements with Lafourche Parish Hospital Service District No. 2 (Lafourche), which owns and operates St. Anne General Hospital and related facilities (St. Anne) of Raceland, Louisiana. Under the agreements, Ochsner leases the St. Anne buildings and facilities, purchased working capital and certain equipment of St. Anne, and operates the hospital for a specified period of time. As part of the agreement, Ochsner entered into an unsecured note payable with Lafourche for the purchase of its working capital and equipment for \$7.1 million. On June 1, 2015, Ochsner and Lafourche executed an amendment in which the aggregate principal and accrued interest amount of approximately \$8.4 million was extended to 2026 with six 5-year renewal options, to coincide with the lease agreement. The interest rate on the working capital note, based on the 5-Year Yield Tax Exempt Insured Revenue Bond Rate published by Bloomberg, was 1.76% and 1.85% at December 31, 2017 and 2016, respectively. All amounts are classified as non-current at December 31, 2017 and 2016, and are included in long-term debt on the consolidated balance sheets.

March 2013 Note Payable

Pursuant to its purchase of two Medical Office Buildings on November 15, 2012, OCF entered into a loan in the principal amount of \$7.0 million on March 12, 2013. The loan is secured by first mortgage liens on medical office building properties at 1850 East Gause Boulevard (North Shore Medical Office Building 1) and 105 Medical Center Drive (North Shore Medical Office Building 2), both in Slidell, Louisiana, and both in close proximity to Ochsner Medical Center – North Shore. The loan is in the form of a Senior Secured Note bearing interest at the fixed annual rate of 4.61%. Principal and interest payments are due monthly based upon a 20-year (240-month) amortization period and actual/360-day interest period.

December 2013 Note Payable

Ochsner entered into a loan in the principal amount of \$63.0 million on December 30, 2013. The loan is secured by first mortgage liens on Ochsner facilities at 2005 Veterans Memorial Boulevard, Metairie, Louisiana, and 1950 Gause Boulevard, Slidell, Louisiana. The loan is in the form of a Senior Secured Note bearing interest at the fixed annual rate of 5.26%. Principal and interest payments are due monthly based upon a 15-year (180-month) amortization period and actual/360-day interest period.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

December 2013 Promissory Note

Ochsner entered into a loan with a financial institution (the 2013 Loan) in the principal amount of \$20.8 million on December 31, 2013. The 2013 Loan is in the form of a promissory note bearing stated interest of 30-day LIBOR plus 2.00%. The security includes a pledge of all present and future accounts receivable of Ochsner and a mortgage of certain property. Principal and interest payments are due monthly based upon a 15-year (180-month) fixed principal payment amortization period with the balance of the outstanding principal due on a 7-year maturity date of December 30, 2020, and actual/360-day interest period. As part of a program to manage interest rate risk, OHS entered into an interest rate swap agreement on December 19, 2013, effective as of December 30, 2013. Ochsner pays a 1.97% fixed interest rate on the outstanding notional amount based on the outstanding principal balance of the 2013 Loan to the counterparty and receives the floating amount of 30-day LIBOR as of the date of rate-set. The effect of the swap agreement is to fix Ochsner's interest rate on the 2013 Loan at 3.97%. At December 31, 2017, the fair value of the interest rate swap agreement was an asset of \$8,000 and is included within other assets in the consolidated balance sheet. At December 31, 2016, the fair value of the interest rate swap agreement was a liability of \$171,000, and is included in other long-term liabilities in the consolidated balance sheet.

July 2014 Note Payable

Ochsner entered into a loan in the principal amount of \$80.0 million on July 31, 2014. The loan is secured by first mortgage liens on Ochsner facilities at 17000 Medical Center Drive, Baton Rouge, Louisiana, and 16777 Medical Center Drive, Baton Rouge, Louisiana. The loan is in the form of a Senior Secured Note bearing interest at the fixed annual rate of 5.09%. Principal and interest payments are due monthly based upon a 20-year (240-month) amortization period and actual/360-day interest period.

October 2014 Promissory Note

Ochsner entered into a loan with a financial institution (the 2014 Loan) in the principal amount of \$22.0 million on October 30, 2014. The 2014 Loan is in the form of a promissory note bearing stated interest of 3.75%. The security includes a pledge of all present and future accounts receivable of Ochsner and a mortgage of certain property. Principal and interest payments are due quarterly with the first payment due on February 1, 2015, and based upon a 15-year fixed principal payment amortization period. The balance of the outstanding principal is due on a 7-year maturity date of October 31, 2021, and actual/360-day interest period.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

September 2015 Promissory Note

Ochsner entered into a loan with a financial institution (the 2015 Loan) in the principal amount of \$30.0 million on September 30, 2015. The 2015 Loan is in the form of a promissory note bearing stated interest of 3-month LIBOR plus 2.25%. The security includes a pledge of all present and future accounts receivable of Ochsner and a mortgage of certain property. Principal and interest payments are due quarterly beginning January 1, 2016, based upon a 10-year fixed quarterly principal payment amortization period, with the balance of the outstanding principal due on a 7-year maturity date of September 30, 2022, and actual/360-day interest period. As part of a program to manage interest rate risk, OHS entered into an interest rate swap agreement on September 1, 2015, effective as of September 30, 2015. Ochsner pays a 1.88% fixed interest rate on the outstanding notional amount based on the outstanding principal balance of the 2015 Loan to the counterparty and receives the floating amount of 3-month LIBOR as of the date of rate-set. The effect of the swap agreement is to fix Ochsner's interest rate on the 2015 Loan at 4.13%. The fair value of the interest rate swap agreement was an asset of \$212,000 and \$7,000 at December 31, 2017 and 2016, respectively, and is included within other assets in the consolidated balance sheets.

At December 31, 2017, scheduled repayments of long-term debt for the next five fiscal years are as follows (in thousands):

Years ending December 31:	
2018	\$ 13,299
2019	13,616
2020	20,224
2021	23,870
2022	20,075

10. Employee Benefit Plans

Defined Benefit Pension Plan

Certain employees of Ochsner and its subsidiaries are covered under a defined benefit pension plan (the Defined Benefit Plan). The Defined Benefit Plan is non-contributory and provides benefits that are based on the participants' credited service and average compensation during the

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plans (continued)

last five years of covered employment. As of December 31, 2006, benefit accruals ceased for all plan participants under age 40 and those over age 40 who elected to freeze their retirement plan benefits. Ochsner made an additional change to the Defined Benefit Plan, and as of December 31, 2009, benefit accruals ceased for all plan participants under age 55 with less than 10 years of service (rounded to the nearest 6 months). Physician/executive participants are frozen as of December 31, 2009, regardless of age or service. Participants who were not frozen as of December 31, 2009, accrue benefits until the earlier of age 65 or December 31, 2015. No new participants are allowed to enter the Defined Benefit Plan. Ochsner makes contributions to its qualified plan that satisfy the minimum funding requirements under the Employee Retirement Income Security Act of 1974. These contributions are intended to provide not only for benefits attributed to services rendered to date but also those expected to be earned in the future.

The following table sets forth the changes in benefit obligations, changes in plan assets, and components of net periodic benefit cost (in thousands):

	December 31,	
	2017	2016
Change in benefit obligation:		
Benefit obligation – beginning of year	\$ 553,815	\$ 542,801
Service cost	–	–
Interest cost	22,477	23,619
Actuarial loss	27,296	22,379
Benefits paid	(25,662)	(34,984)
Benefit obligation – end of year	<u>577,926</u>	<u>553,815</u>
Change in plan assets:		
Fair value of plan assets – beginning of year	404,409	406,618
Actual return on plan assets	52,514	22,165
Employer contributions	15,091	10,610
Benefits paid	(25,662)	(34,984)
Fair value of plan assets – end of year	<u>446,352</u>	<u>404,409</u>
Funded status	<u>\$ (131,574)</u>	<u>\$ (149,406)</u>

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plans (continued)

	December 31,	
	2017	2016
Amounts recognized in the consolidated balance sheets consist of:		
Pension and postretirement obligations – current portion	\$ –	\$ –
Pension and postretirement obligations – non-current portion	(131,574)	(149,406)
Unrestricted net assets	N/A	N/A
Amounts recognized in unrestricted net assets:		
Net actuarial loss	251,647	253,845
Prior service credit	–	–
Total amounts recognized	<u>251,647</u>	<u>253,845</u>
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:		
Net loss	5,518	32,623
Recognized loss	(7,716)	(6,840)
Recognized prior service credit	–	–
Total amounts recognized	<u>\$ (2,198)</u>	<u>\$ 25,783</u>

Weighted average assumptions used to determine projected benefit obligations at December 31 were as follows:

	2017	2016
Weighted average discount rate	3.70%	4.15%
Rate of compensation increase	N/A	N/A

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plans (continued)

Net periodic pension cost (benefit) for the years ended December 31 includes the following components (in thousands):

	<u>2017</u>	<u>2016</u>
Service cost	\$ —	\$ —
Interest cost	22,477	23,619
Expected return on plan assets	(30,735)	(32,409)
Amortization of net loss	7,716	6,840
Recognized prior service credit	—	—
Net periodic pension benefit	<u>\$ (542)</u>	<u>\$ (1,950)</u>

Weighted average assumptions used to determine net periodic pension cost for the years ended December 31 were as follows:

	<u>2017</u>	<u>2016</u>
Weighted-average discount rate	4.15%	4.35%
Expected return on plan assets	7.70%	7.70%
Rate of compensation increase	N/A	N/A

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plans (continued)

The fair values of the Defined Benefit Plan assets at December 31 are included in the tables below (in thousands).

	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Observable Identical Assets and Liabilities (Level 1) ^(a)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Estimated Fair Value
2017				
Money market funds	\$ 22,960	\$ –	\$ –	\$ 22,960
Fixed income investments	17,649	–	–	17,649
Marketable equity securities	48,531	–	–	48,531
Absolute return	28,411	–	–	28,411
Natural resources	28,029	–	–	28,029
Total	\$ 145,580	\$ –	\$ –	\$ 145,580
2016				
Money market funds	\$ 28,126	\$ –	\$ –	\$ 28,126
Fixed income investments	16,994	–	–	16,994
Marketable equity securities	71,874	–	–	71,874
Absolute return	10,807	–	–	10,807
Natural resources	27,731	–	–	27,731
Total	\$ 155,532	\$ –	\$ –	\$ 155,532

^(a) Valuation of these securities classified as Level 1 is based on unadjusted quoted prices in active markets that are readily and regularly available.

These tables do not include Level 2 or 3 alternative investments of \$300.8 million and \$248.9 million at December 31, 2017 and 2016, respectively, which are measured at fair value using net asset value as a practical expedient. In the year ended December 31, 2017, a publicly traded security was de-listed; therefore, at December 31, 2017, this is accounted for as an alternative investment and is not included in these tables.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plans (continued)

The Defined Benefit Plan asset allocation as of the measurement dates (December 31, 2017 and 2016) and the target asset allocation, presented as a percentage of total plan assets, were as follows:

	2017	2017 Target Allocation	2016
Debt securities	13%	15%	16%
Equity securities	42	40	40
Private equity/venture capital	3	2	4
Hedge funds	27	33	25
Natural resources/REITs	10	10	8
Other	5	–	7

Asset allocations and investment performance are formally reviewed at regularly scheduled meetings several times during the year by the Investment Committee of Ochsner. Ochsner utilizes an investment consultant and multiple managers for different asset classes. The Investment Committee takes into account liquidity needs of the plan to pay benefits in the short term and the anticipated long-term obligations of the Defined Benefit Plan.

The primary financial objectives of the Defined Benefit Plan are to (1) provide a stream of relatively predictable, stable, and constant earnings in support of the Defined Benefit Plan's annual benefit obligations and (2) preserve and enhance the real (inflation-adjusted) value of the assets of the Defined Benefit Plan. The long-term investment objectives of the Defined Benefit Plan are to (1) attain the average annual total return assumed in the Defined Benefit Plan's most recent actuarial assumptions (net of investment management fees) over rolling five-year periods, (2) outperform the Defined Benefit Plan's custom benchmark, and (3) outperform the median return of a pool of retirement funds to be identified in conjunction with Ochsner's investment consultant.

The asset allocation is designed to provide a diversified mix of asset classes, including U.S. and foreign equity securities, fixed income securities, real estate investment trusts (REITs), natural resources, cash, and funds to hedge against deflation and inflation. Risk management practices include various criteria for each asset class, including measurement against several benchmarks, achievement of a positive risk-adjusted return, and investment guidelines for each class of assets that enumerate types of investment allowed in each category.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plans (continued)

The Ochsner Retirement Plan Statement of Investment Policies and Objectives provides for a range of minimum and maximum investments in each asset class to allow flexibility in achieving the expected long-term rate of return. Historical return patterns and correlations, consensus return forecast, and other relevant financial factors are analyzed to check for reasonableness and appropriateness of the asset allocation to ensure that the probability of meeting actuarial assumptions is reasonable. Ochsner Treasury staff oversees the day-to-day activities involving assets of the Defined Benefit Plan and the implementation of any changes adopted by the Investment Committee.

Ochsner currently expects to make a contribution to the Defined Benefit Plan of approximately \$17.6 million in 2018.

For 2017 and 2016, Ochsner's Defined Benefit Plan had accumulated benefit obligations of approximately \$577.9 million and \$553.8 million, respectively.

The estimated net loss for the Defined Benefit Plan that will be amortized from accumulated unrestricted net assets into net periodic benefit cost over the next fiscal year is approximately \$7.7 million.

Future benefit payments expected to be paid in each of the next five fiscal years and in the aggregate for the following five years as of December 31, 2017, are as follows (in thousands):

Years ending December 31:	
2018	\$ 27,787
2019	29,347
2020	30,681
2021	31,973
2022	33,079
2023–2027	176,725
	<u>\$ 329,592</u>

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plans (continued)

Defined Contribution Plans

All employees of Ochsner meeting eligibility requirements may participate in the Ochsner Clinic Foundation 401(k) Plan (the Plan). Ochsner may annually elect to make a retirement contribution on behalf of eligible employees in an amount up to 2% of the participant's annual eligible compensation. In addition, Ochsner may annually elect to make a match for eligible employees of 50% of the first 4% the employees contribute into the Plan. At December 31, 2017 and 2016, OHS has accrued approximately \$30.2 million and \$28.1 million, respectively, for matching contributions to the Plan for the 2017 and 2016 fiscal years, respectively.

Certain Ochsner employees are also covered under a 457(f) plan. The 457(f) plan was created to replace 100% of the benefit target for employees under age 65 as of December 31, 2009, whose benefits in the Defined Benefit Plan were frozen. The participant pays taxes at vesting and payout occurs at the later of age 65 or retirement. Participants of the 457(f) plan also participate in the 401(k) contributions. OHS' accompanying consolidated balance sheets reflect a liability of approximately \$13.9 million and \$13.6 million for the 457(f) plan at December 31, 2017 and 2016, respectively.

Other Postretirement Benefits

Ochsner also provides certain health care and life insurance benefits for retired employees. Ochsner funds these benefits on a pay-as-you-go basis. The obligations under the postretirement plan are approximately \$1.6 million and \$2.0 million at December 31, 2017 and 2016, respectively.

11. Endowment Funds and Temporarily and Permanently Restricted Net Assets

Ochsner has 799 temporarily restricted funds and 70 permanently restricted funds established for a variety of purposes. These funds are classified and reported based on the existence or absence of donor-imposed restrictions. Restricted net assets include funds dedicated to Medical Education, Nursing Education, Pastoral Care, Biomedical Research, Cancer Research, Cardiology Research, Transplant Research, and Alzheimer's Research.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**11. Endowment Funds and Temporarily and Permanently Restricted Net Assets
(continued)**

ASC 958-205, *Not-for-Profit Entities – Presentation of Financial Statements*, provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA), which the state of Louisiana enacted on July 1, 2010.

UPMIFA requires Ochsner to classify the portion of each donor-restricted endowment fund that is not classified as permanently restricted net assets as temporarily restricted net assets (time restricted) until appropriated for expenditure. Temporarily restricted net assets available for appropriations at December 31, 2017 and 2016, total approximately \$7.8 million and \$6.8 million, respectively. Management retroactively adopted UPMIFA as of January 1, 2009.

UPMIFA also requires that Ochsner preserve the historic dollar value of the donor-restricted endowed funds. Therefore, permanently restricted net assets contain the aggregate fair market value of (1) an endowment fund at the time it became an endowment fund, (2) each subsequent donation to the fund at the time it is made, and (3) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund.

Restricted Net Assets as of December 31, 2017, by Purpose

	Temporarily Restricted	Permanently Restricted	Total
	<i>(In Thousands)</i>		
Research	\$ 17,465	\$ 18,439	\$ 35,904
Education	6,150	3,643	9,793
Other	76,591	4,601	81,192
Total	\$ 100,206	\$ 26,683	\$ 126,889

Restricted Net Assets as of December 31, 2016, by Purpose

	Temporarily Restricted	Permanently Restricted	Total
	<i>(In Thousands)</i>		
Research	\$ 13,402	\$ 17,671	\$ 31,073
Education	5,685	3,488	9,173
Other	69,132	4,674	73,806
Total	\$ 88,219	\$ 25,833	\$ 114,052

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**11. Endowment Funds and Temporarily and Permanently Restricted Net Assets
(continued)**

Endowment Net Asset Composition by Type of Fund as of December 31, 2017				
	Temporarily Restricted		Permanently Restricted	Total
	Unrestricted	Restricted	Restricted	
	<i>(In Thousands)</i>			
Donor-restricted funds	\$ –	\$ 14,563	\$ 26,683	\$ 41,246
Board-designated funds	1,559	–	–	1,559
Total	\$ 1,559	\$ 14,563	\$ 26,683	\$ 42,805

Endowment Net Asset Composition by Type of Fund as of December 31, 2016				
	Temporarily Restricted		Permanently Restricted	Total
	Unrestricted	Restricted	Restricted	
	<i>(In Thousands)</i>			
Donor-restricted funds	\$ –	\$ 10,399	\$ 25,833	\$ 36,232
Board-designated funds	1,391	–	–	1,391
Total	\$ 1,391	\$ 10,399	\$ 25,833	\$ 37,623

Changes in Endowment Net Assets for the Year Ended December 31, 2017				
	Temporarily Restricted		Permanently Restricted	Total
	Unrestricted	Restricted	Restricted	
	<i>(In Thousands)</i>			
Beginning balance	\$ 1,391	\$ 10,399	\$ 25,833	\$ 37,623
Investment gain	194	5,030	16	5,240
Contributions	–	–	835	835
Appropriations for expenditures	(26)	(866)	(1)	(893)
Ending balance	\$ 1,559	\$ 14,563	\$ 26,683	\$ 42,805

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**11. Endowment Funds and Temporarily and Permanently Restricted Net Assets
(continued)**

Changes in Endowment Net Assets for the Year Ended December 31, 2016				
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
	<i>(In Thousands)</i>			
Beginning balance	\$ 1,341	\$ 8,668	\$ 23,763	\$ 33,772
Investment gain	87	2,300	8	2,395
Contributions	–	5	2,042	2,047
Appropriations for expenditures	(37)	(554)	–	(591)
Transfers	–	(20)	20	–
Ending balance	<u>\$ 1,391</u>	<u>\$ 10,399</u>	<u>\$ 25,833</u>	<u>\$ 37,623</u>

Funds With Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or current law requires Ochsner to retain as a fund of perpetual duration. In accordance with U.S. GAAP, deficiencies of this nature are reported in unrestricted net assets. There were no such deficiencies as of December 31, 2017 or 2016.

Return Objectives and Risk Parameters

Ochsner has investment and spending practices for endowment assets that intend to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that Ochsner must hold in perpetuity or for a donor-specified period(s) as well as board-designated funds. The policy allows the endowment assets to be invested in a manner that is intended to produce results that exceed the price and yield results of the allocation index while assuming a moderate level of investment risk. Ochsner expects its endowment funds to provide a rate of return that preserves the gift and generates earnings to achieve the endowment purpose.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Endowment Funds and Temporarily and Permanently Restricted Net Assets (continued)

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, Ochsner relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and interest and dividend income. Ochsner uses a diversified asset allocation to achieve its long-term return objectives within prudent risk constraints to preserve capital.

Spending Policy and How the Investment Objectives Relate to Spending Policy

It is Ochsner's objective to establish a payout rate from endowment accounts that provides a stable, predictable level of spending for the endowed purposes that will increase with the rate of inflation, and to continue to invest in accordance with policy goals of providing for a rate of growth in the endowment earnings that meets or exceeds the rate of inflation. The annual spending appropriation will be subject to a minimum rate of 4% and a maximum rate of 7% of each endowment fund's current market value. Temporarily restricted net assets, along with other donor-restricted funds, include the spending appropriation and investment income of the endowments and are pending appropriation for expenditure consistent with the specific purpose of the fund.

12. Business Combinations, Strategic Partnerships, and Affiliation Agreements

Business Combinations

During 2017 and 2016, Ochsner completed several physician practice acquisitions, none of which were material to the results of operations. In 2016, Ochsner also purchased 100% of the equity interest of Sculpting Center of New Orleans, LLC.

On January 9, 2017, Ochsner completed the acquisition of Millennium Healthcare Management, Inc. (MHM). MHM is a leading provider of urgent care and occupational medicine in Louisiana and consists of 12 urgent care and 4 occupational health clinics. Under the terms of the acquisition, Ochsner paid approximately \$30.8 million in cash. Results of operations of MHM have been included in its consolidated financial statements from the date of acquisition.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Business Combinations, Strategic Partnerships, and Affiliation Agreements (continued)

Strategic Partnerships and Affiliation Agreements

In recent years, Ochsner has entered into several strategic partnership and affiliation agreements. While the direct financial impact of these agreements is not material, they are a component of Ochsner's efforts to increase local access to care, improve quality, reduce the cost of health care, and share best practices and resources in order to improve the health of Louisiana communities. Ochsner now has strategic partnerships and clinical affiliations with Lafayette General Health, CHRISTUS Health Louisiana, IASIS Glenwood Regional Medical Center, and Southwest Mississippi Regional Medical Center.

Ochsner also has Joint Operating Agreements (JOA) with St. Tammany Parish Hospital (STPH), Terrebonne General Medical Center (TGMC), and Slidell Memorial Hospital (SMH). These JOAs are intended to coordinate resources with the goal of lowering costs, improving quality, and creating a seamless clinical environment for patients in each of their respective local regions. STPH, TGMC, and SMH all remain public hospitals governed by their respective Boards. Ochsner is financially integrated with these hospitals and recognizes other operating revenue or other operating expense related to the JOAs in its consolidated statements of operations.

Ochsner also provides management assistance and support for Chabert, SCPH and, beginning November 2017, SBPH. Under these management agreements, Ochsner receives management fees and any excess of revenues over expenses generated by each of the facilities annually, as well as reimbursement of purchased services incurred on behalf of the facilities. Ochsner also has a management agreement with Hancock. Under its management agreement with Hancock, Ochsner receives management fees as well as reimbursement of expenses incurred for providing management assistance and support services; see further discussion in subsequent event caption below.

In October 2016, Ochsner entered into a professional services agreement with Adeptus Health, Inc. (Adeptus) to enhance access to emergency medical care in Louisiana. Ochsner opened a freestanding emergency department in Marrero, Louisiana, and Adeptus managed the operations. On March 30, 2017, Ochsner and Adeptus terminated this agreement and the previously established joint venture.

In December 2017, Ochsner, the state of Louisiana (State), the Board of Supervisors of Louisiana State University and Agricultural and Mechanical College (LSU), and the Biomedical Research Foundation (BRF) signed Letters of Intent (LOI) to create a new, long-term, Public Private Partnership agreement in Shreveport and Monroe. Under the proposed agreement, LSU and

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Business Combinations, Strategic Partnerships, and Affiliation Agreements (continued)

Ochsner will jointly form a new University Health System (UHS) structure to coordinate activities between the school and the health care delivery system. This agreement is expected to be effective in 2018.

Subsequent Events

On January 2, 2018, Ochsner completed the acquisition of New Orleans Urgent Care (NOUC), which consists of two urgent care clinics for approximately \$1.2 million in cash. Results of operations of NOUC will be included in Ochsner's consolidated financial statements from the date of acquisition.

On January 19, 2018, Ochsner completed an asset purchase agreement with NOLA Weightloss, LLC for approximately \$167,000. Ochsner acquired the seller's interest in and rights to operate a Medi-Weightloss franchise business, as well as other considerations.

In March 2018, Ochsner signed a membership interest purchase agreement with CHRISTUS Health (CHRISTUS) to acquire a 40% minority ownership interest in CHRISTUS Health Southwestern Louisiana (SWLA). SWLA owns and operates health care facilities and operations related to physician practices in Louisiana, including CHRISTUS St. Patrick Hospital, CHRISTUS Lake Area Medical Center, and various clinical facilities. CHRISTUS St. Patrick Hospital is a 50-bed hospital and CHRISTUS Lake Area Medical Center is an 88-bed, full-service acute care hospital in Lake Charles, Louisiana. This purchase is expected to close during the second half of 2018 once regulatory approval is received.

On April 1, 2018, Ochsner completed an agreement to lease Hancock Medical Center, a 102-bed acute care hospital, six related medical office buildings, and equipment. This new agreement terminated the existing management agreement. The net present value of lease payments to be paid over the life of the 25-year capital lease is approximately \$12.5 million, and Ochsner will own the property at the end of the lease term. As part of this transaction, Ochsner will acquire the current assets, liabilities, and provider number of Hancock. Results of operations of Hancock will be included in Ochsner's consolidated financial statements from the transaction date.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

13. Equity Method Investments and Joint Ventures

Investment in Equity Investees

Ochsner's investment in unconsolidated affiliates at December 31 and its income from equity investees for the years then ended are as follows (in thousands):

	Ownership Interest	Investment in Equity Investees	Equity in Income of Equity Investees
2017			
Southeast Louisiana Homecare LLC	25%	\$ 2,999	\$ (122)
Louisiana Extended Care Hospital of Kenner, LLC	25%	356	17
OSR Louisiana, LLC	49%	—	(156)
Ochsner-Acadia, LLC	25%	6,586	458
OMC West JV, LLC	49%	5,860	—
		<u>\$ 15,801</u>	<u>\$ 197</u>
2016			
Southeast Louisiana Homecare LLC	25%	\$ 3,176	\$ 359
Louisiana Extended Care Hospital of Kenner, LLC	25%	82	123
OSR Louisiana, LLC	49%	—	(252)
Ochsner-Acadia, LLC	25%	6,994	—
		<u>\$ 10,252</u>	<u>\$ 230</u>

On June 15, 2015, Ochsner entered into a joint venture, OSR Louisiana, LLC, with Pennsylvania-based Select Medical Corporation to jointly open a new, 60-bed, acute inpatient rehabilitation hospital. Construction began in early 2016 and the joint venture commenced patient service operations at the new facility in April 2018. This joint venture did not have material operations during the year ended December 31, 2017.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

13. Equity Method Investments and Joint Ventures

On May 17, 2016, Ochsner formed a joint venture, Ochsner-Acadia, LLC, with Acadia Healthcare (Acadia) to open and operate an 82-bed behavioral health facility in Laplace, Louisiana. Ochsner contributed the facility and recorded a gain of \$6,994 for a 25% interest in the joint venture and Acadia will contribute the facility build-out, equipment, and working capital. Construction began in 2016 and the facility opened in November 2017. The results of the joint venture's operations were not material to its consolidated financial statements for the year ended December 31, 2017.

On December 20, 2017, Ochsner entered into a joint venture with a commercial real estate company to form OMC West JV, LLC (OMC West). The focus of the new partnership is to own and provide property management for a medical building located at 2614 Jefferson Highway in Jefferson, Louisiana. The five-story, 129,875 square-foot medical building will house three separate health care components, including long-term acute care, inpatient rehabilitation, and a skilled nursing facility. Ochsner is the lessor of the building and will make future minimum lease payments to OMC West for this lease totaling approximately \$43.5 million over 10 years. Ochsner also subleases space to its equity-method investments OSR Louisiana, LLC, and Louisiana Extended Care Hospital of Kenner, LLC, and will receive approximately \$39.8 million over 10 years. These lease amounts are included in Ochsner's lessee and lessor commitments disclosed in Note 17 to the consolidated financial statements. The results of Ochsner's equity-method investment in OMC West were not material in 2017.

14. Electronic Health Records Services Agreements

In order to develop a better clinical integration and provide cost savings for its JOA partners and equity-method investments, Ochsner has entered into electronic health records services and hosting agreements to implement and support a common EHR system. During 2015, Ochsner implemented its EHR system at STPH and continues to host and maintain it. During 2017, Ochsner implemented its EHR system at TGMC, the clinics of SMH, and its equity-method investment with Acadia and continues to host and maintain them.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

15. Functional Expenses

Ochsner provides general health care services primarily to residents within its geographic location. Expenses related to providing these services for the years ended December 31 are as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Health care services	\$ 2,050,580	\$ 1,858,093
General and administrative	820,973	790,743
Medical education	30,019	38,716
Research	15,201	13,999
Fitness center	11,634	12,310
Hotel	3,618	3,546
Total	<u>\$ 2,932,025</u>	<u>\$ 2,717,407</u>

16. Supplemental Disclosures of Cash Flow Information

	<u>Year Ended December 31,</u>	
	<u>2017</u>	<u>2016</u>
Cash paid for interest (net of amounts capitalized)	<u>\$ 49,871</u>	<u>\$ 52,567</u>
Supplemental non-cash investing and financing activities:		
Property purchases included in accounts payable	<u>\$ 14,186</u>	<u>\$ 14,625</u>
Property purchases financed by capital leases and long-term debt	<u>\$ 2,852</u>	<u>\$ 6,474</u>

17. Commitments and Contingencies

Professional and General Liability Insurance

Professional and general liability claims have been asserted against Ochsner by various claimants. The claims are in various stages of processing, and some may ultimately be brought to trial. Incidents occurring through December 31, 2017, may result in the assertion of additional claims.

Ochsner participates in a risk management program to provide for professional and general liability coverage.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

17. Commitments and Contingencies (continued)

Under this program, Ochsner carries professional and general liability insurance coverage for up to \$65.0 million each of annual aggregate claims subject to certain deductible provisions. Ochsner is self-insured with respect to the first \$3.0 million of each claim for professional liability with an annual aggregate exposure of \$6.0 million. General liability claims are subject to a retention of \$1.0 million per claim and \$2.0 million annual aggregate. Ochsner also carries additional coverage on certain community hospitals that carry similar coverage with lower self-retention and aggregate levels.

Professional liability claims are limited by Louisiana statute to \$500,000 per occurrence, the first \$100,000 of which is payable by the health care provider and the remainder of which is payable by the Patient's Compensation Fund (the Fund) for participants in the Fund. The Fund was established by the Medical Malpractice Act (the Act), which was enacted in 1975 by the state of Louisiana. The Act established the Fund and limited recovery in medical malpractice cases to \$500,000. The limitation on recovery has been challenged and, to date, successfully defended in the courts. Expenditures recorded by Ochsner for participation in the Fund for the years ended December 31, 2017 and 2016, were approximately \$18.8 million and \$17.9 million, respectively, and are included in other operating expenses in the accompanying consolidated statements of operations.

Ochsner has an established trust fund held by a financial institution. Disbursements are made from the trust fund for self-insured professional and general liability claims, claims administration costs, and legal fees. The amounts to be contributed to the trust funds are determined annually by an independent actuary. The trust fund assets for Ochsner in the aggregate totaled approximately \$9.3 million and \$9.1 million at December 31, 2017 and 2016, respectively. The trust fund assets are included in assets limited as to use under self-insurance trust fund in the accompanying consolidated balance sheets. The estimated liability recorded by Ochsner in the aggregate for claims, based on the actuarial report, is approximately \$14.1 million with no estimated reinsurance recoveries at December 31, 2017, and \$13.8 million with no estimated reinsurance recoveries at December 31, 2016. The estimated liability is included in other current liabilities and other long-term liabilities in the accompanying consolidated balance sheets. The estimated liability for Ochsner was discounted at approximately 2.5% at both December 31, 2017 and 2016. If the risk management program is terminated, the trust fund balances, if any, revert to Ochsner after satisfaction of outstanding claims. Any proceeds from such a reversion would be used to reduce future costs for liability coverage.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

17. Commitments and Contingencies (continued)

Estimated Workers' Compensation and Employee Health Claims

Ochsner is self-insured for workers' compensation and employee health claims. The estimated liability for workers' compensation and employee health claims totaled approximately \$17.6 million and \$18.8 million at December 31, 2017 and 2016, respectively, which is included in accrued salaries, wages, and benefits; other current liabilities; and other long-term liabilities in the accompanying consolidated balance sheets.

Property Insurance

Ochsner carries property insurance coverage through third-party insurers. The policy limit is \$750.0 million and is subject to a deductible of \$250,000 per occurrence for property damage and 24 hours for the time element. The Named Wind sublimit is \$160.0 million. The Named Wind deductible is 3% for property damage and 72 hours for the time element, subject to a minimum of \$500,000 and a maximum of \$50.0 million. Ochsner also carried coverage on certain community hospitals with self-retention and aggregate levels.

Lease Commitments

Ochsner leases certain software and equipment under capital leases. The capital lease obligations are included in other current liabilities and other non-current liabilities in the accompanying consolidated balance sheets.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

17. Commitments and Contingencies (continued)

Additionally, Ochsner leases assets under various rental agreements. Ochsner leases have varying terms, which may include renewal or purchase options and escalation clauses that are factored into determining minimum lease payments. The following schedule summarizes its future annual minimum rental commitments on outstanding leases as of December 31, 2017 (in thousands):

	<u>Lease Obligations</u>	
	<u>Capital</u>	<u>Operating</u>
2018	\$ 6,825	\$ 48,592
2019	2,931	40,743
2020	1,834	35,645
2021	476	31,757
2022	153	29,371
Thereafter	—	195,924
Total minimum lease payments	<u>12,219</u>	<u>\$ 382,032</u>
Less amounts representing interest	<u>(538)</u>	
	11,681	
Less current maturities	<u>(6,560)</u>	
Capital lease obligations – non-current	<u>\$ 5,121</u>	

Rent expense, which includes operating leases and cancelable short-term rental agreements, was approximately \$64.0 million and \$53.5 million for the years ended December 31, 2017 and 2016, respectively.

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

17. Commitments and Contingencies (continued)

Operating Leases – Lessor

Ochsner leases office space to other businesses. Lease terms generally range from one to four years, with options of renewal for additional periods. All such property leases provide for minimum annual rentals, and all rental revenue has been recorded on a straight-line basis. Following is a schedule by years of future minimum rental payments under non-cancelable operating leases as of December 31, 2017 (in thousands):

Years ending December 31:	
2018	\$ 6,785
2019	6,653
2020	5,469
2021	5,304
2022	5,298
Thereafter	30,079
Total minimum lease payments to be received	<u>\$ 59,588</u>

Contingencies

The health care industry as a whole is subject to numerous complex laws and regulations of federal, state, and local governments. Compliance with these laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Such compliance with laws and regulations in the health care industry has come under increased government scrutiny. Ochsner and its subsidiaries are parties to various legal proceedings and potential claims arising in the ordinary course of their business. Management of Ochsner believes the reserves it has established for these issues are adequate and does not believe, based on current facts and circumstances and after review with counsel, that these matters will have a material adverse effect on its consolidated statements of financial position or results of operations.

The Tax Relief and Health Care Act of 2006 authorized a permanent program involving the use of third-party recovery audit contractors (RACs) to identify Medicare and Medicaid overpayments and underpayments made to providers. RACs are compensated based on the amount of both overpayments and underpayments they identify by reviewing claims submitted to Medicare for correct coding and medical necessity. Payment recoveries resulting from RAC reviews are

Ochsner Clinic Foundation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

17. Commitments and Contingencies (continued)

appealable through administrative and judicial processes. Payment recoveries and denials resulting from RAC reviews can be appealed through administrative and judicial processes, and management intends to pursue the reversal of adverse determinations where appropriate. In addition to overpayments that are not reversed on appeal, Ochsner will incur additional costs to respond to requests for records and to pursue the reversal of payment denials. Ochsner expects the RACs will continue to seek CMS approval to review additional issues.

Management of Ochsner believes that the reserves it has established for RAC reviews, which are included in other long-term liabilities in the accompanying consolidated balance sheets, are adequate but cannot predict with certainty the impact of the Medicare and Medicaid RAC program on its future consolidated results of operations or cash flows.

18. Subsequent Events

Ochsner has evaluated subsequent events through April 23, 2018, the date the accompanying consolidated financial statements were available for issuance.

Ochsner Clinic Foundation and Subsidiaries

Schedule of Compensation Information

Year Ended December 31, 2017

Chief Executive Officer: Warner L. Thomas

None of the Chief Executive Officer's compensation is paid from public funds received by Ochsner Clinic Foundation and subsidiaries.



Ernst & Young LLP
3900 One Shell Square
701 Poydras Street
New Orleans, LA 70139

Tel: +1 504 581 4200
Fax: +1 504 596 4233
ey.com

Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Directors and Management
Ochsner Clinic Foundation and Subsidiaries

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Ochsner Clinic Foundation and its subsidiaries (Ochsner Clinic Foundation), which comprise the consolidated balance sheet as of December 31, 2017, and the related consolidated statements of operations, changes in net assets, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated April 23, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Ochsner Clinic Foundation's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Ochsner Clinic Foundation's internal control. Accordingly, we do not express an opinion on the effectiveness of Ochsner Clinic Foundation's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Ochsner Clinic Foundation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst + Young LLP

April 23, 2018



Ernst & Young LLP
3900 One Shell Square
701 Poydras Street
New Orleans, LA 70139

Tel: +1 504 581 4200
Fax: +1 504 596 4233
ey.com

Report of Independent Auditors on Compliance for the Major Federal Program; Report on Internal Control Over Compliance and Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

The Board of Directors and Management
Ochsner Clinic Foundation and Subsidiaries

Report on Compliance for the Major Federal Program

We have audited Ochsner Clinic Foundation and its subsidiaries' (Ochsner Clinic Foundation) compliance with the types of compliance requirements described in the US Office of Management and Budget (OMB) *Compliance Supplement* that could have a direct and material effect on Ochsner Clinic Foundation's major federal program for the year ended December 31, 2017. Ochsner Clinic Foundation's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for Ochsner Clinic Foundation's major federal program based on our audit of the types of compliance requirements referred to above.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Ochsner Clinic Foundation's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of Ochsner Clinic Foundation's compliance.

Opinion on the Major Federal Program

In our opinion, Ochsner Clinic Foundation complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2017.

Report on Internal Control Over Compliance

Management of Ochsner Clinic Foundation is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Ochsner Clinic Foundation's internal control over compliance with the types of requirements that could have a direct and material effect on its major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Ochsner Clinic Foundation's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the consolidated financial statements of Ochsner Clinic Foundation as of and for the year ended December 31, 2017, and have issued our report thereon dated April 23, 2018, which contained an unmodified opinion on those consolidated financial statements. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Ernst + Young LLP

June 28, 2018

Ochsner Clinic Foundation and Subsidiaries

Schedule of Expenditures of Federal Awards

Year Ended December 31, 2017

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Research and Development Cluster	Other Federal Expenditures	Total Federal Expenditures	Amounts Provided to Subrecipients
U.S. Department of Defense						
Pass-Through From:						
<i>Mayo Clinic</i>						
Military Medical Research and Development	12.420	W81XWH-15-1-0293	\$ 1,646	\$ -	\$ 1,646	\$ -
Total U.S. Department of Defense			<u>1,646</u>	<u>-</u>	<u>1,646</u>	<u>-</u>
U.S. Department of Education						
Pass-Through From:						
<i>Louisiana Department of Education</i>						
Special Education Grants to States	84.027	H027A160033	-	38,095	38,095	-
Total U.S. Department of Education			<u>-</u>	<u>38,095</u>	<u>38,095</u>	<u>-</u>
U.S. Department of Health and Human Services						
Pass-Through From:						
<i>Duke University/Duke Clinical Research Institute</i>						
Food and Drug Administration Research	93.103	R18FD005292	514	-	514	-
<i>Mount Sinai Medical Center of Florida, Inc.</i>						
Research and Training in Complementary and Integrative Health	93.213	4UH3AT009149-02	13,439	-	13,439	-
<i>University of Pittsburgh</i>						
Minority Health and Health Disparities Research	93.307	5R01MD009118-04	14,576	-	14,576	-
Direct Award:						
National Center for Advancing Translational Sciences	93.350		256,803	-	256,803	44,200

Ochsner Clinic Foundation and Subsidiaries

Schedule of Expenditures of Federal Awards (continued)

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Research and Development Cluster	Other Federal Expenditures	Total Federal Expenditures	Amounts Provided to Subrecipients
U.S. Department of Health and Human Services (continued)						
Direct Award:						
Cancer Treatment Research	93.395		\$ 620,512	\$ -	\$ 620,512	\$ -
Pass-Through From:						
<i>Alliance for Clinical Trials in Oncology</i>						
Cancer Treatment Research	93.395	1U10CA180821	1,240	-	1,240	-
<i>Children's Hospital of Philadelphia (CHOP)</i>						
Cancer Treatment Research	93.395	U10CA180886	815	-	815	-
<i>Radiation Therapy Oncology Group Community Clinical Oncology Program</i>						
Cancer Treatment Research	93.395	U10 CA0037422	90	-	90	-
<i>Total CFDA 93.395</i>			<u>622,657</u>	<u>-</u>	<u>622,657</u>	<u>-</u>
<i>Eastern Cooperative Oncology Group</i>						
Cancer Control	93.399	3U10 CA37403-15	20,302	-	20,302	-
<i>Brigham and Women's Hospital</i>						
Cardiovascular Diseases Research	93.837	5U01HL130163-02	31,350	-	31,350	-
<i>Duke University/Duke Clinical Research Institute</i>						
Cardiovascular Diseases Research	93.837	4U10HL084904	20,315	-	20,315	-
<i>University of Alabama</i>						
Cardiovascular Diseases Research	93.837	SUH01HL120338-03	8,105	-	8,105	-
<i>New England Research Institutes, Inc.</i>						
Cardiovascular Diseases Research	93.837	U01HL107407	7,949	-	7,949	-
<i>Northwestern University</i>						
Cardiovascular Diseases Research	93.837	5R01HL126117-02	73,093	-	73,093	-
<i>Columbia University Health Sciences</i>						
Cardiovascular Diseases Research	93.837	1R01HL130500-01A1 REVISED	58,725	-	58,725	-
<i>Total CFDA 93.837</i>			<u>199,537</u>	<u>-</u>	<u>199,537</u>	<u>-</u>

Ochsner Clinic Foundation and Subsidiaries

Schedule of Expenditures of Federal Awards (continued)

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Research and Development Cluster	Other Federal Expenditures	Total Federal Expenditures	Amounts Provided to Subrecipients
U.S. Department of Health and Human Services (continued)						
<i>George Washington University</i>						
Lung Diseases Research	93.838	2R01HL098354-04	\$ 36,175	\$ -	\$ 36,175	\$ -
<i>University of South Florida</i>						
Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847	1UC4DK097835-01	19,745	-	19,745	-
<i>Mayo Clinic Jacksonville</i>						
Extramural Research Programs in the Neurosciences and Neurological Disorders	93.853	1U01NS08168-01A1	61,809	-	61,809	-
<i>Massachusetts General Hospital</i>						
Extramural Research Programs in the Neurosciences and Neurological Disorders	93.853	1U01NS090259-01 A1	19,639	-	19,639	-
<i>Total CFDA 93.853</i>			<u>81,448</u>	<u>-</u>	<u>81,448</u>	<u>-</u>
<i>Duke University/Duke Clinical Research Institute</i>						
Allergy and Infectious Diseases Research	93.855	UM1AI104681	7,410	-	7,410	-
<i>Washington University</i>						
Child Health and Human Development Extramural Research	93.865	5R01HD086007-02	56,206	-	56,206	-
<i>Louisiana Hospital Association Research & Education Foundation</i>						
National Bioterrorism Hospital Preparedness Program	93.889		-	34,018	34,018	-
Total U.S. Department of Health and Human Services			<u>1,328,812</u>	<u>34,018</u>	<u>1,362,830</u>	<u>44,200</u>
Total Expenditures of Federal Awards			<u>\$ 1,330,458</u>	<u>\$ 72,113</u>	<u>\$ 1,402,571</u>	<u>\$ 44,200</u>

See accompanying notes to schedule of expenditures of federal awards.

Ochsner Clinic Foundation and Subsidiaries

Notes to Schedule of Expenditures of Federal Awards

Year Ended December 31, 2017

1. General

The schedule of expenditures of federal awards (SEFA) includes the federal award activity of Ochsner Clinic Foundation and its subsidiaries (Ochsner Clinic Foundation) under programs of the federal government for the year ended December 31, 2017. The information in the SEFA is presented in accordance with Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

2. Basis of Accounting

Expenditures reported on the SEFA are reported on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles. Expenditures are recognized following the cost principles contained in the Uniform Guidance or OMB Circular A-122, *Cost Principles for Non-Profit Organizations*. Therefore, some amounts presented in the SEFA may differ from amounts presented in, or used in the preparation of, the consolidated financial statements.

3. Indirect Cost Rate

Ochsner Clinic Foundation did not use the 10% de minimis indirect cost rate allowed by the Uniform Guidance.

Ochsner Clinic Foundation and Subsidiaries

Schedule of Findings and Questioned Costs

For the Year Ended December 31, 2017

Section I—Summary of Auditor’s Results

Financial Statements

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP:

Unmodified

Internal control over financial reporting:

Material weakness(es) identified?	_____	yes	<u> X </u>	no
Significant deficiency(ies) identified?	_____	yes	<u> X </u>	none reported
Noncompliance material to financial statements noted?	_____	yes	<u> X </u>	no

Federal Awards

Internal control over major federal programs:

Material weakness(es) identified?	_____	yes	<u> X </u>	no
Significant deficiency(ies) identified?	_____	yes	<u> X </u>	none reported

Type of auditor’s report issued on compliance for major federal programs:

Unmodified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?

_____ yes X no

Identification of major federal programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
-----------------------	---

12.420, 93.103, 93.213, 93.307, 93.350, 93.395, 93.399, 93.837, 93.838, 93.847, 93.853, 93.855, 93.865, 93.889	Research and Development Cluster
---	----------------------------------

Dollar threshold used to distinguish between Type A and Type B programs:

_____ \$ 750,000

Auditee qualified as low-risk auditee?

_____ yes X no

Ochsner Clinic Foundation and Subsidiaries

Schedule of Findings and Questioned Costs (continued)

Section II—Financial Statement Findings

There were no financial statement findings.

Section III—Federal Award Findings and Questioned Costs

There were no federal award findings or questioned costs.

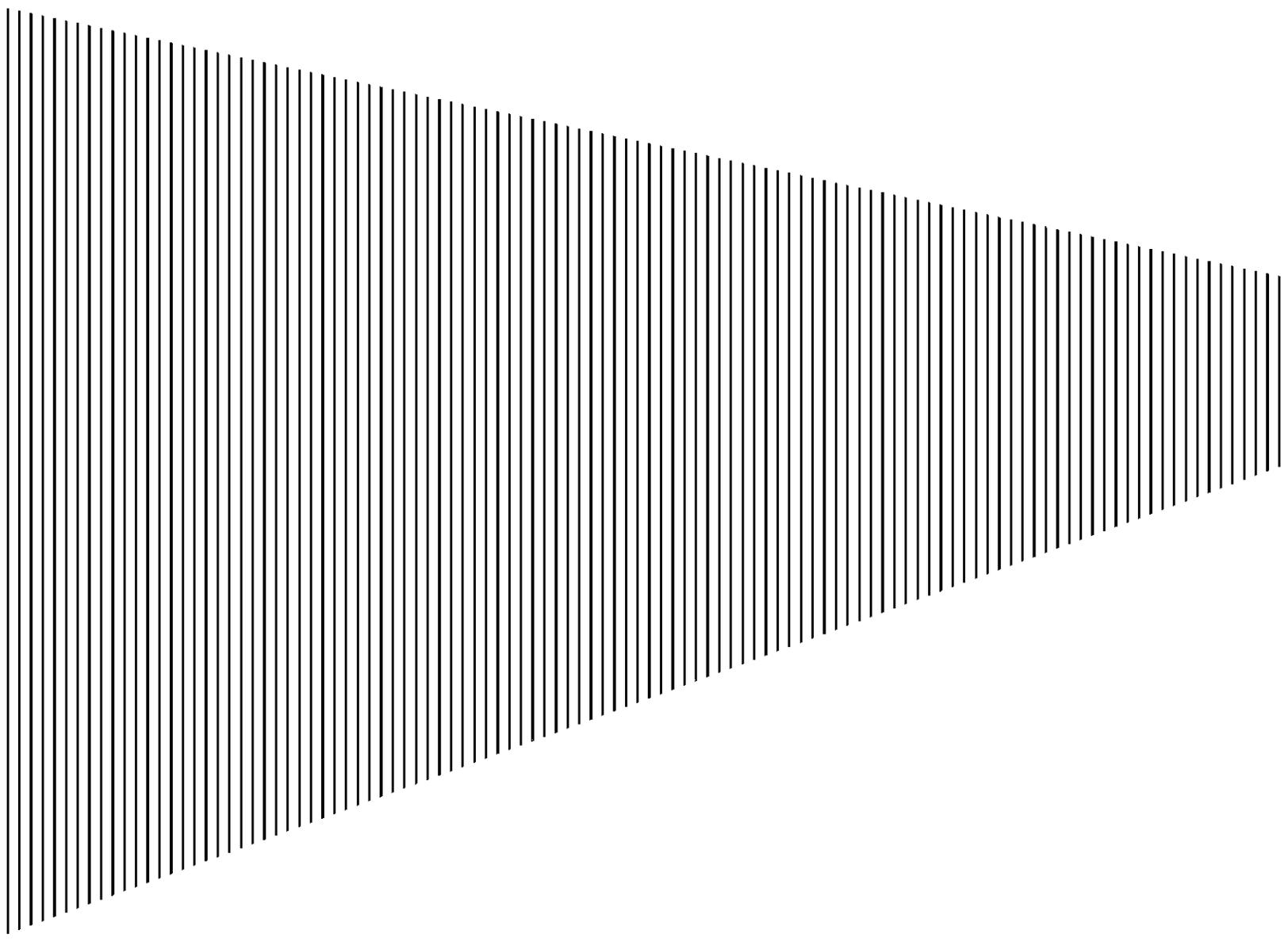
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Summary Schedule of Prior Audit Findings

For the Year Ended December 31, 2017

There were no findings in 2016.

There were no uncorrected findings in 2015.

Ochsner Health System, a part of Ochsner Clinic Foundation

1514 Jefferson Highway • New Orleans, LA 70121 • phone 504-842-3000 • www.ochsner.org



Ernst & Young LLP
3900 One Shell Square
701 Poydras Street
New Orleans, LA 70139

Tel: +1 504 581 4200
Fax: +1 504 596 4233
ey.com

Report of Independent Accountants on Applying Agreed-Upon Procedures

To the Management of Ochsner Clinic Foundation:

We have performed the procedures enumerated below, which were agreed to by the management of Ochsner Clinic Foundation (d/b/a/ Ochsner Health System or the System) and the Louisiana Legislative Auditor (LLA), on the control and compliance (C/C) areas identified in the LLA's Statewide Agreed-Upon Procedures (AUPs) for the fiscal period January 1, 2017 through December 31, 2017. The sufficiency of these procedures is solely the responsibility of the parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Bank Reconciliations

AUP Requirement:

Obtain a listing of client bank accounts from management and management's representation that the listing is complete.

Using the listing provided by management, select all of the entity's bank accounts (if five accounts or less) or one-third of the bank accounts on a three year rotating basis (if more than 5 accounts). If there is a change in practitioners, the new practitioner is not bound to follow the rotation established by the previous practitioner. Note: School student activity fund accounts may be excluded from selection if they are otherwise addressed in a separate audit or AUP engagement. For each of the bank accounts selected, obtain bank statements and reconciliations for all months in the fiscal period and report whether:

- a) Bank reconciliations have been prepared;
- b) Bank reconciliations include evidence that a member of management or a board member (with no involvement in the transactions associated with the bank account) has reviewed each bank reconciliation; and
- c) If applicable, management has documentation reflecting that it has researched reconciling items that have been outstanding for more than 6 months as of the end of the fiscal period.

Testing Performed

Management represented that there is only one bank account used for the cash disbursements and receipts of public funds; therefore, we obtained the bank statements and bank reconciliations for



each month from January 1, 2017 to December 31, 2017 for that account. We inspected evidence that each bank reconciliation was prepared timely, included evidence of management review, and reconciling items older than six months were researched and documented.

No Findings Noted

This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and applicable standards of Government Auditing Standards. We were not engaged to and did not conduct an examination or review, the objective of which would be the expression of an opinion or conclusion, respectively, on those C/C areas identified in the AUPs. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of management of Ochsner Clinic Foundation, and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

June 29, 2018



AUDIT SERVICES REPORT ON APPLYING LOUISIANA STATEWIDE AGREED-UPON PROCEDURES

To the Board of Directors of Ochsner Health System and the Louisiana Legislative Auditor:

We have performed the procedures enumerated below, which were agreed to by Ochsner Health System (Entity) and the Louisiana Legislative Auditor (LLA) on the control and compliance (C/C) areas identified in the LLA's Statewide Agreed-Upon Procedures (SAUPs) for the fiscal period January 1, 2017 through December 31, 2017. The Entity's management is responsible for those C/C areas identified in the SAUPs. The purpose of these procedures is to improve accountability, transparency and decrease the number of cases of fraud, waste and abuse of public funds.

This agreed-upon procedures engagement was conducted in conformity with the International Standards for the Professional Practice of Internal Auditing. The sufficiency of these procedures is solely the responsibility of the specified users of this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

During 2017, Ochsner received the following publicly funded grants:

1. Mental Health Plan for Schools Protocol
2. Emergency Preparedness
3. FEMA

The procedures and associated results are noted beginning on page 2.

We were not engaged to and did not conduct an examination or review, the objective of which would be the expression of an opinion or conclusion, respectively, on those C/C areas identified in the SAUPs. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

The purpose of this report is solely to describe the scope of testing performed on those C/C areas identified in the SAUPs, and the result of that testing, and not to provide an opinion on control or compliance. Accordingly, this report is not suitable for any other purpose. Under Louisiana Revised Statute 24:513, this report is distributed by the LLA as a public document.

A handwritten signature in blue ink, appearing to read "Angelle B. Granier", is written over a horizontal line.

Angelle B. Granier
Vice President and Chief Audit Executive, Audit Services
Ochsner Health System
New Orleans, LA
April 30, 2018

Agreed Upon Procedures	Results
Written Policies and Procedures	
<p>1. Obtain the entity’s written policies and procedures and report whether those written policies and procedures address each of the following financial/business functions (or report that the entity does not have any written policies and procedures), as applicable:</p> <ul style="list-style-type: none"> a. Budgeting, including preparing, adopting, monitoring, and amending the budget. b. Purchasing, including (1) how purchases are initiated; (2) how vendors are added to the vendor list; (3) the preparation and approval process of purchase requisitions and purchase orders; (4) controls to ensure compliance with the public bid law; and (5) documentation required to be maintained for all bids and price quotes. c. Disbursements, including processing, reviewing, and approving. d. Receipts, including receiving, recording, and preparing deposits. e. Contracting, including (1) types of services requiring written contracts, (2) standard terms and conditions, (3) legal review, (4) approval process, and (5) monitoring process. 	<p>1. Completed.</p> <ul style="list-style-type: none"> a. No written policy exists for budgeting; however, Ochsner has a monthly process that includes operational leadership presenting their budget to actual variances to executive and system leadership. These results are combined and shared with the board quarterly. b. Written policies and procedures exist addressing items (1) through (3). Items (4) and (5) are not documented in written policies and procedures because, as a non-governmental agency, Ochsner is not statutorily bound by the Louisiana Procurement Code or public bid law. However, Ochsner does follow public bid requirements for items reimbursed by FEMA as well as other government grants when contractually required. c. No exceptions noted. d. No exceptions noted. e. No exceptions noted.

Agreed Upon Procedures	Results
<p>f. Credit Cards (and debit cards, fuel cards, P-Cards, if applicable), including (1) how cards are to be controlled, (2) allowable business uses, (3) documentation requirements (4) required approvers, and (5) monitoring card usage.</p>	<p>f. Written policies and procedures address items (1) through (4). Although the written policies and procedures do not address the process for monitoring card usage, Ochsner’s Accounts Payable and Treasury Departments perform a monthly review of 100% of the credit card transactions and related support to ensure compliance with entity policies and procedures. This process is evaluated annually by Ochsner’s internal audit function.</p>
Board	
<p>2. Obtain and review the board/committee minutes for the fiscal period, and:</p> <p>a. Report whether the managing board met (with a quorum) at least monthly, or on a frequency in accordance with the board’s enabling legislation, charter, or other equivalent document.</p> <p>b. Report whether the minutes referenced or included monthly budget-to-actual comparisons on the General Fund and any additional funds identified as major funds in the entity’s prior audit (GAAP-basis).</p> <ul style="list-style-type: none"> • If the budget-to-actual comparisons show that management was deficit spending during the fiscal period, report whether there is a formal/written plan to eliminate the deficit spending for those entities with a fund balance deficit. If there is a formal/written plan, report whether the meeting minutes for at least one board meeting during the fiscal period reflect that the board is monitoring the plan. 	<p>2. Completed.</p> <p>a. Ochsner’s Board of Directors meets with a quorum quarterly as well as for one annual board meeting, as required by their charter.</p> <p>b. The minutes for 2017 reference budget-to-actual variances for the general ledger, which is the General Fund for a non-governmental entity. The budget-to-actual comparisons did not show that management was deficit spending during the fiscal period.</p>

Agreed Upon Procedures	Results
<p>c. Report whether the minutes referenced or included non-budgetary financial information (e.g. approval of contracts and disbursements) for at least one meeting during the fiscal period.</p>	<p>c. The minutes also referenced contracts and disbursements for major projects.</p>
<p>Bank Reconciliations</p>	
<p>3. Obtain a listing of client bank accounts from management and management’s representation that the listing is complete.</p> <p>4. Using the listing provided by management, select all of the entity’s bank accounts (if five accounts or less) or one-third of the bank accounts on a three-year rotating basis (if more than 5 accounts). If there is a change in practitioners, the new practitioner is not bound to follow the rotation established by the previous practitioner. Note: School student activity fund accounts may be excluded from selection if they are otherwise addressed in a separate audit or AUP engagement. For each of the bank accounts selected, obtain bank statements and reconciliations for all months in the fiscal period and report whether:</p> <p>a. Bank reconciliations have been prepared;</p> <p>b. Bank reconciliations include evidence that a member of management or a board member (with no involvement in the transactions associated with the bank account) has reviewed each bank reconciliation; and</p> <p>c. If applicable, management has documentation reflecting that it has researched reconciling items that have been</p>	<p><i>This procedure was performed by EY, Ochsner’s external audit firm.</i></p>

Agreed Upon Procedures	Results
<p>outstanding for more than 6 months as of the end of the fiscal period.</p>	
<p>Disbursements – General (excluding credit card/debit card/fuel card/P-Card purchases or payments)</p>	
<p>5. Obtain a listing of entity disbursements from management or, alternately, obtain the general ledger and sort/filter for entity disbursements. Obtain management’s representation that the listing or general ledger population is complete.</p> <p>6. Using the disbursement population from #3 above, randomly select 25 disbursements (or randomly select disbursements constituting at least one-third of the dollar disbursement population if the entity had less than 25 transactions during the fiscal period), excluding credit card/debit card/fuel card/P-card purchases or payments. Obtain supporting documentation (e.g. purchase requisitions, system screens/logs) for each transaction and report whether the supporting documentation for each transaction demonstrated that:</p> <ul style="list-style-type: none"> a. Purchases were initiated using a requisition/purchase order system or an equivalent electronic system that separates initiation from approval functions in the same manner as a requisition/purchase order system. b. Purchase orders, or an electronic equivalent, were approved by a person who did not initiate the purchase. 	<p>5. Completed.</p> <p>6. Completed.</p> <ul style="list-style-type: none"> a. All purchases were initiated using Lawson, an electronic purchase order system that separates the initiation and approval functions. b. 18 of the 25 selected were approved by a person who did not initiate the purchase. The remaining seven purchase orders were approved systematically. Requests under \$500 or within the purchase initiator’s system defined spending limits are automatically approved within Lawson. All purchase orders are reviewed by a Supply Chain Department Buyer prior to being released to vendors.

Agreed Upon Procedures	Results
<p>c. Payments for purchases were not processed without (1) an approved requisition and/or purchase order, or electronic equivalent; a receiving report showing receipt of goods purchased, or electronic equivalent; and an approved invoice.</p> <p>7. Using entity documentation (e.g. electronic system control documentation, policy manual, written procedure), report whether the person responsible for processing payments is prohibited from adding vendors to the entity's purchasing/disbursement system.</p> <p>8. Using entity documentation (e.g. electronic system control documentation, policy manual, written procedure), report whether the persons with signatory authority or who make the final authorization for disbursements have no responsibility for</p>	<p>c. Payments were not processed without an approved requisition, an approved purchase order, an approved invoice and a receiving report where applicable:</p> <ul style="list-style-type: none"> • 16 of the 25 purchases were supported by a receiving report; • One of the 25 was an invoice for freight related to a purchase not included in the testing sample. • The remaining 8 purchases were for services rendered by physicians as required by the grant and the physicians' contract agreements. The procedure to confirm the receipt of services rendered includes the Assistant Vice President of that department reviewing and approving the physician's timesheet submitted with their monthly invoice. <p>7. Review of the Lawson User Access reports indicated that the individuals who are responsible for processing payments are prohibited from adding vendors.</p> <p>8. Additionally, the responsibility of initiating purchases resides with the Purchasing Department which is separate from the Accounts Payable Department who is responsible for the final authorization for disbursements.</p>

Agreed Upon Procedures	Results
<p>initiating or recording purchases.</p> <p>9. Inquire of management and observe whether the supply of unused checks is maintained in a locked location, with access restricted to those persons that do not have signatory authority, and report any exceptions. Alternately, if the checks are electronically printed on blank check stock, review entity documentation (electronic system control documentation) and report whether the persons with signatory authority have system access to print checks.</p> <p>10. If a signature stamp or signature machine is used, inquire of the signer whether his or her signature is maintained under his or her control or is used only with the knowledge and consent of the signer. Inquire of the signer whether signed checks are likewise maintained under the control of the signer or authorized user until mailed. Report any exceptions.</p>	<p>9. Checks are electronically printed on blank check stock and review of system reports demonstrates that the individuals with signature authority do not have the access to print checks.</p> <p>10. The signature of the individuals with check signing authority are electronically maintained in Lawson, the accounting system. Signed checks are maintained by the Accounts Payable Department and the Mailroom until distributed to vendors for payment.</p>
Credit Cards/Debit Cards/Fuel Cards/P-Cards	
<p>11. Obtain from management a listing of all active credit cards, bank debit cards, fuel cards, and P-cards (cards), including the card numbers and the names of the persons who maintained possession of the cards. Obtain management's representation that the listing is complete.</p> <p>12. Using the listing prepared by management, randomly select 10 cards (or at least one-third of the cards if the entity has less than 10 cards) that were used during the fiscal period, rotating cards each year. If there is a change in practitioners, the new practitioner is not bound to follow the rotation established by</p>	<p>11. Completed.</p> <p>12. Based on our review of the general ledger activity for the three grants received from the state of Louisiana during 2017 (Mental Health Plan for Schools Protocol, Emergency Preparedness, and FEMA), only the Emergency Preparedness grants had transactions. Only the card of the System Assistant Vice President of Security and Emergency Preparedness was utilized</p>

Agreed Upon Procedures	Results
<p>the previous practitioner.</p> <p>Obtain the monthly statements, or combined statements if multiple cards are on one statement, for the selected cards. Select the monthly statement or combined statement with the largest dollar activity for each card (for a debit card, select the monthly bank statement with the largest dollar amount of debit card purchases) and:</p> <p>a. Report whether there is evidence that the monthly statement or combined statement and supporting documentation was reviewed and approved, in writing, by someone other than the authorized card holder. [Note: Requiring such approval may constrain the legal authority of certain public officials (e.g., mayor of a Lawrason Act municipality); these instances should not be reported.]]</p> <p>b. Report whether finance charges and/or late fees were assessed on the selected statements.</p> <p>13. Using the monthly statements or combined statements selected under #10 above, obtain supporting documentation for all transactions for each of the 10 cards selected (i.e. each of the 10 cards should have one month of transactions subject to testing).</p> <p>a. For each transaction, report whether the transaction is supported by:</p> <ul style="list-style-type: none"> • An original itemized receipt (i.e., identifies precisely what was purchased) 	<p>for these transactions.</p> <p>Review of the monthly statement for September 2017, which had the largest dollar activity (\$2,800) supported that:</p> <p>a. The statement was reviewed and approved, in writing by the cardholder's leader. The Accounts Payable Department also reviewed the statement and supporting documentation.</p> <p>b. No finance charges or late fees were assessed.</p> <p>13. Completed.</p> <p>a. The transactions were supported by original receipts and aligned with purchasing and disbursement written policies and procedures. The business purpose was documented.</p>

Agreed Upon Procedures	Results
<ul style="list-style-type: none"> • Documentation of the business/public purpose. For meal charges, there should also be documentation of the individuals participating. • Other documentation that may be required by written policy (e.g., purchase order, written authorization.) <p>b. For each transaction, compare the transaction’s detail (nature of purchase, dollar amount of purchase, supporting documentation) to the entity’s written purchasing/disbursement policies and the Louisiana Public Bid Law (i.e. transaction is a large or recurring purchase requiring the solicitation of bids or quotes) and report any exceptions.</p> <p>c. For each transaction, compare the entity’s documentation of the business/public purpose to the requirements of Article 7, Section 14 of the Louisiana Constitution, which prohibits the loan, pledge, or donation of funds, credit, property, or things of value, and report any exceptions (e.g. cash advances or non-business purchases, regardless whether they are reimbursed). If the nature of the transaction precludes or obscures a comparison to the requirements of Article 7, Section 14, the practitioner should report the transaction as an exception.</p>	<p>b. The Louisiana’s Public Bid Law was not applicable to the transactions.</p> <p>c. The transactions reviewed that were purchased with state funds were for the one-time purchase of emergency preparedness supplies and not a loan, pledge, donation of funds, credit, property or things of value as prohibited by Article 7, Section 14 of the Louisiana Constitution.</p>

Agreed Upon Procedures	Results
Contracts	
<p>14. Obtain a listing of all contracts in effect during the fiscal period or, alternately, obtain the general ledger and sort/filter for contract payments. Obtain management's representation that the listing or general ledger is complete.</p> <p>15. Using the listing above, select the five contract "vendors" that were paid the most money during the fiscal period (excluding purchases on state contract and excluding payments to the practitioner). Obtain the related contracts and paid invoices and:</p> <p>a. Report whether there is a formal/written contract that supports the services arrangement and the amount paid.</p> <p>b. Compare each contract's detail to the Louisiana Public Bid Law or Procurement Code. Report whether each contract is subject to the Louisiana Public Bid Law or Procurement Code and:</p> <ul style="list-style-type: none"> • If yes, obtain/compare supporting contract documentation to legal requirements and report whether the entity complied with all legal requirements (e.g., solicited quotes or bids, advertisement, selected lowest bidder). • If no, obtain supporting contract documentation and report whether the entity solicited quotes as a best practice. 	<p>14. Completed.</p> <p>15. Completed.</p> <p>a. Of the five vendors selected, four of the five had a formal/written contract that supports the service arrangements and amounts paid.</p> <p>b. As a non-government entity, Ochsner is not statutorily or contractually bound to the Louisiana Bid Law or Procurement Code.</p>

Agreed Upon Procedures	Results
<p>c. Report whether the contract was amended. If so, report the scope and dollar amount of the amendment and whether the original contract terms contemplated or provided for such an amendment.</p> <p>d. Select the largest payment from each of the five contracts, obtain the supporting invoice, compare the invoice to the contract terms, and report whether the invoice and related payment complied with the terms and conditions of the contract.</p> <p>e. Obtain/review contract documentation and board minutes and report whether there is documentation of board approval, if required by policy or law (e.g. Lawrason Act or Home Rule Charter).</p>	<p>c. One of the four contracts included an amendment to extend the term of the original product supplier agreement, which had an effective date of August 2012 and a term of three years with the option to extend by two additional years. On December 31, 2016, the termination date of the original contract, July 31, 2017, was extended to July 2022. The original contract provided for the extension.</p> <p>d. For the four vendors with a contract, the supporting invoice for the largest payment aligned with the contract terms and conditions.</p> <p>e. Ochsner is not a Louisiana parish nor a municipality; therefore, is not bound by the Lawrason Act or Home Rule Charter.</p>
Other	
<p>16. Inquire of management whether the entity had any misappropriations of public funds or assets. If so, obtain/review supporting documentation and report whether the entity reported the misappropriation to the legislative auditor and the district attorney of the parish in which the entity is domiciled.</p> <p>17. Observe and report whether the entity has posted on its premises and website, the notice required by R.S. 24:523.1. This notice (available for download or print at www.la.gov/hotline) concerns the reporting of misappropriation, fraud, waste, or</p>	<p>16. Per discussion with the System Vice President of Treasury, there were no misappropriations of public funds or assets.</p> <p>17. The notice required by R.S.24.523.1 is posted at Ochsner’s Main Campus facility located at 1514 Jefferson Hwy, New Orleans, Louisiana, 70121, as well as on the company website.</p>

Agreed Upon Procedures	Results
<p>abuse of public funds.</p> <p>18. If the practitioner observes or otherwise identifies any exceptions regarding management’s representations in the procedures above, report the nature of each exception.</p>	<p>18. No exceptions noted.</p>